THE NEW DEMOCRAT

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BLUEPRINT

SPRING 2001

IDEAS FOR A NEW CENTURY

Making The Big CHOICE

Bush's tax plan is a reckless gamble with America's prosperity. There's a better way.

SEN. JOE LIEBERMAN on a New Prosperity Agenda LAWRENCE SUMMERS on managing the economy SEN. EVAN BAYH on the marriage penalty BRUCE REED on the estate tax ROBERT ATKINSON on boosting the New Economy ROBERT SHAPIRO on a payroll tax credit

PLUS: The Editors on how to give a truly progressive tax cut

PENN'S POLL: What Americans really think about Bush's tax cuts

Democratic Leadership Council

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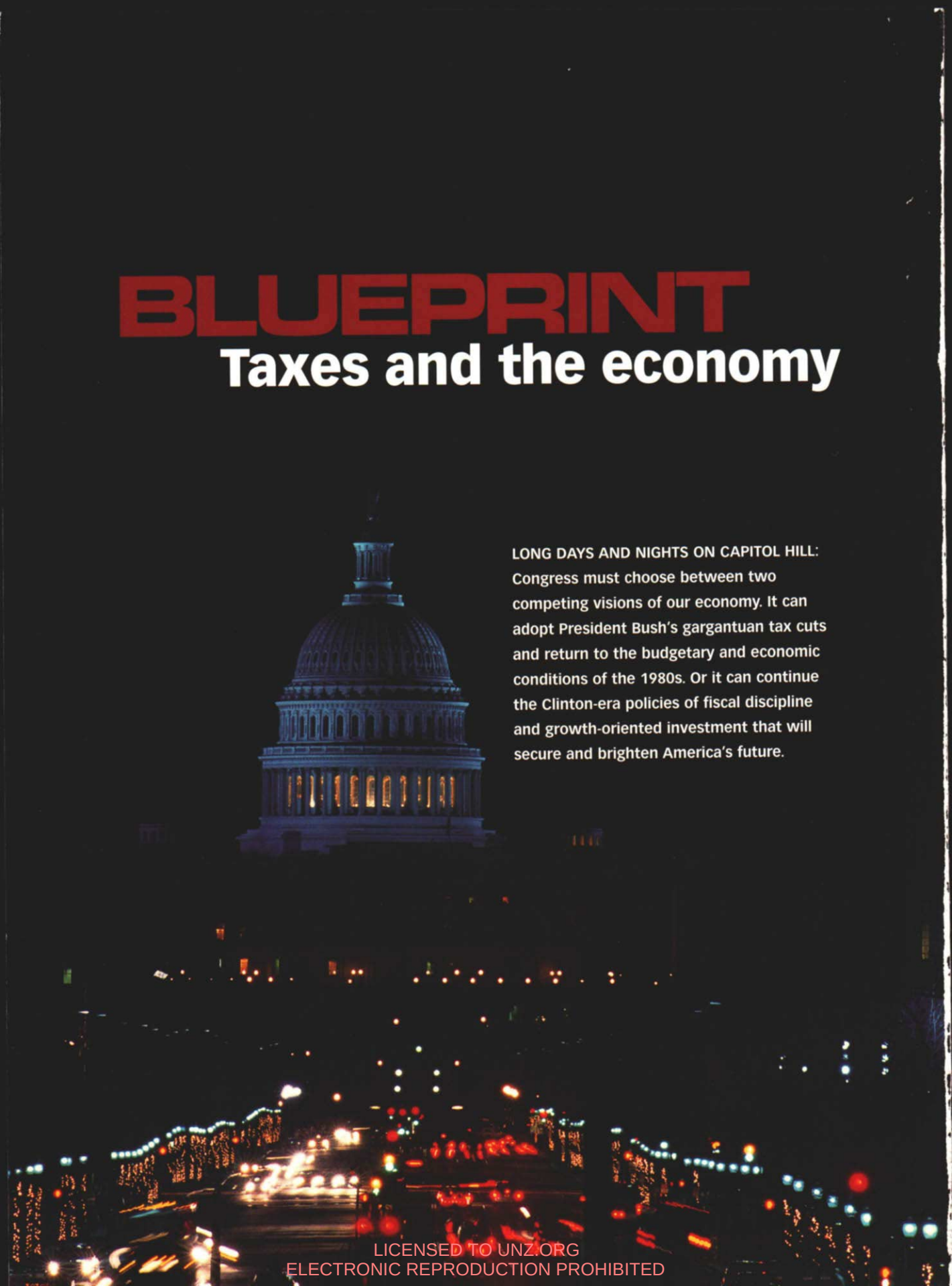
Taxes and the economy



LONG DAYS AND NIGHTS ON CAPITOL HILL: Congress must choose between two competing visions of our economy. It can adopt President Bush's gargantuan tax cuts and return to the budgetary and economic conditions of the 1980s. Or it can continue the Clinton-era policies of fiscal discipline and growth-oriented investment that will secure and brighten America's future.

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Blueprint: Ideas for a New Century is published quarterly by the Democratic Leadership Council, 600 Pennsylvania Ave. S.E., Suite 400, Washington, D.C. 20003. Telephone 202-546-0007. The Democratic Leadership Council is a 501 (c) (4) nonprofit organization. Bulk postage paid at Washington, D.C. The ideas and views expressed in this publication do not necessarily represent official positions of the Democratic Leadership Council, its members, or the Blueprint Board of Advisors. Send all correspondence, remittances, changes of address, and subscription inquiries to: Blueprint, 600 Pennsylvania Ave. S.E., Suite 400, Washington, D.C. 20003.

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Why a massive tax cut?

Early in his administration, President Bush has staked his political future on a massive tax cut that was born purely as an election tactic to fend off flat-taxer Steve Forbes. What began as a mere campaign riposte has thus morphed into the centerpiece of the Bush presidency. And it's an almost completely artificial political bon-bon — who in the land was clamoring for a $1.6 trillion give-back? It sounds like a fuzzy number pulled from a hat.

In this BLUEPRINT, we show that Bush's tax cut is a plan but not a policy. It is not about managing the economy, not even in the short term. It does not begin to answer the biggest question facing the country: how to use the surplus generated by the Clinton administration's successful fiscal management to maintain the unprecedented prosperity of the last decade.

Answering that question, our authors argue, is a matter of making the right choices. Do we prepare for the future, or do we slide into past patterns of budget deficit and rising national debt? Do we recognize that while the sun is out today with a big surplus, rain will come after 2010 in the form of the baby boomer retirement for which we must prepare? The Bush plan is a have-your-cake-and-eat-it-too confection that melts on close scrutiny, say our contributors.

The great lesson of the Clinton-Gore years was fiscal discipline. Harvard President-designate Lawrence H. Summers argues that squandering the surplus on an excessive tax cut would undermine fiscal discipline, weakening our ability to pay down the national debt as a prerequisite of future growth.

The engine of our national prosperity is the New Economy, rumors of whose demise have been greatly exaggerated, writes Robert D. Atkinson, vice president of the Progressive Policy Institute. Productivity increases through the information revolution, says Sen. Joe Lieberman, have given us an Innovation Economy that could be threatened by a massive tax cut that short-changes investments in education and research. Lieberman also recommends an immediate but responsible tax cut — $300 to every taxpayer — that would give a $60 billion boost to the slowing economy.

Fixing the marriage penalty would bring more balance, as well as cash, to the table, argues Sen. Evan Bayh, chairman of the Democratic Leadership Council. And former Undersecretary of Commerce Robert J. Shapiro explains the importance of maintaining the essential fairness — the progressivity — of our tax code by avoiding a huge tax cut for the rich.

DLC President Bruce Reed, a former top White House policy advisor, shows why some of the wealthiest people in America oppose abolishing the estate tax, contrary to President Bush's proposal.

In short, like the mountains of deficits and debt that await us under Bush's plan, the mass of evidence we've assembled shows the weakness of the administration's centerpiece. Our barely elected president claims that his $1.6 trillion tax cut is "just right." In fact, as this magazine shows, it's just wrong.

—Peter Ross Range

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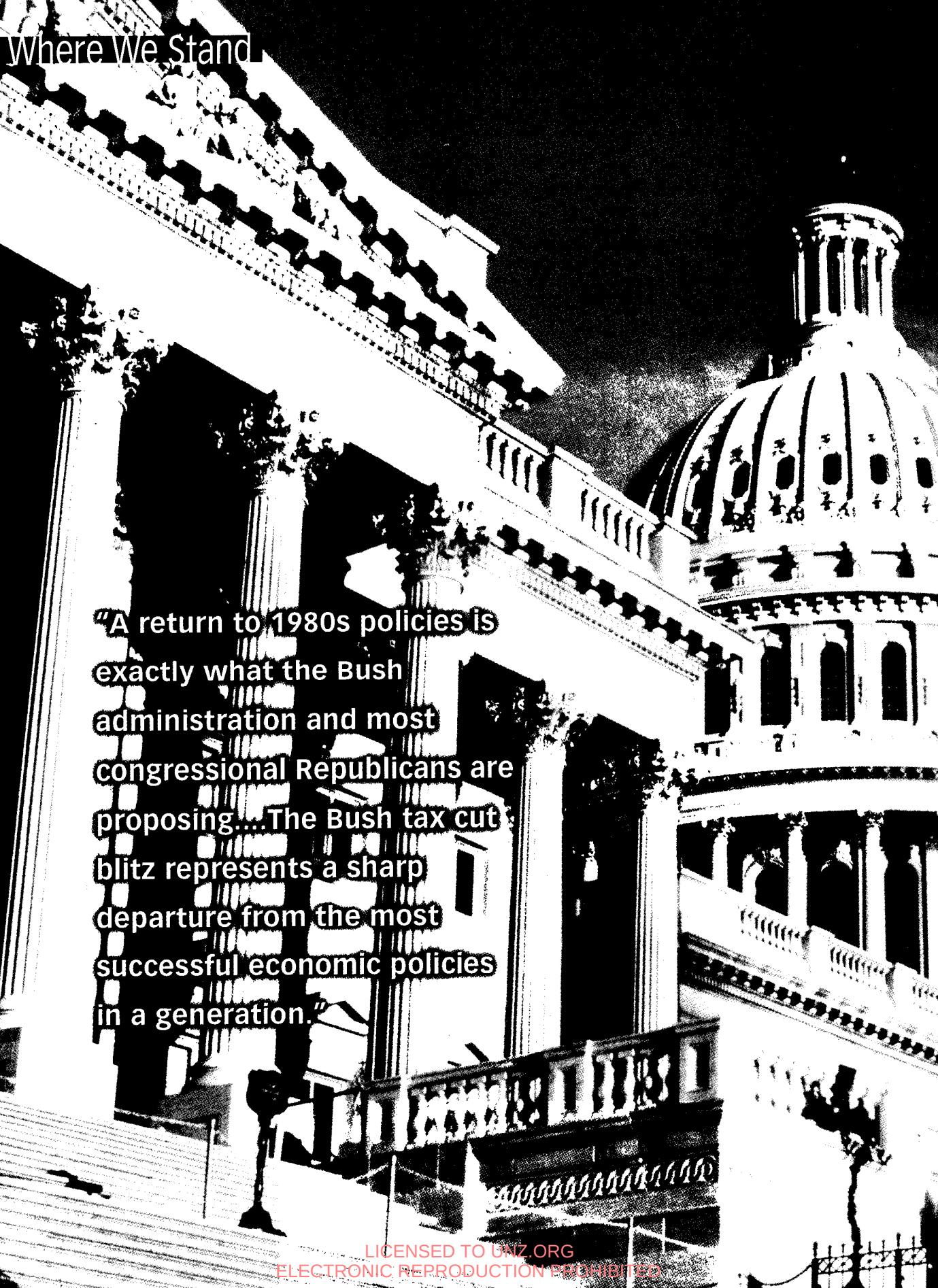
Where We Stand



"A return to 1980s policies is exactly what the Bush administration and most congressional Republicans are proposing....The Bush tax cut blitz represents a sharp departure from the most successful economic policies in a generation."

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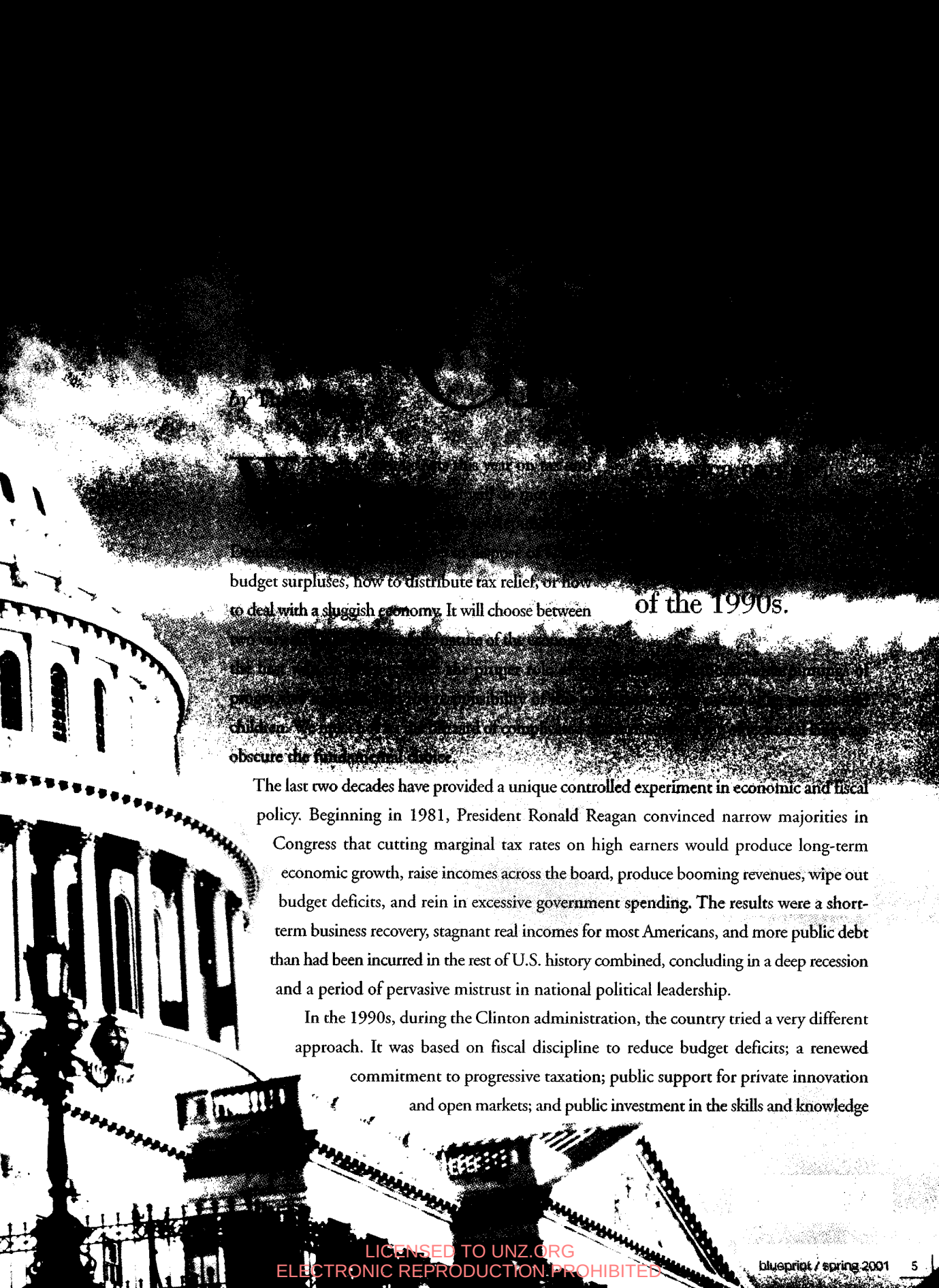

budget surpluses, how to distribute tax relief, or how

to deal with a sluggish economy. It will choose between

of the 1990s.

obscure the fundamental choice.

The last two decades have provided a unique controlled experiment in economic and fiscal policy. Beginning in 1981, President Ronald Reagan convinced narrow majorities in Congress that cutting marginal tax rates on high earners would produce long-term economic growth, raise incomes across the board, produce booming revenues, wipe out budget deficits, and rein in excessive government spending. The results were a short-term business recovery, stagnant real incomes for most Americans, and more public debt than had been incurred in the rest of U.S. history combined, concluding in a deep recession and a period of pervasive mistrust in national political leadership.

In the 1990s, during the Clinton administration, the country tried a very different approach. It was based on fiscal discipline to reduce budget deficits; a renewed commitment to progressive taxation; public support for private innovation and open markets; and public investment in the skills and knowledge

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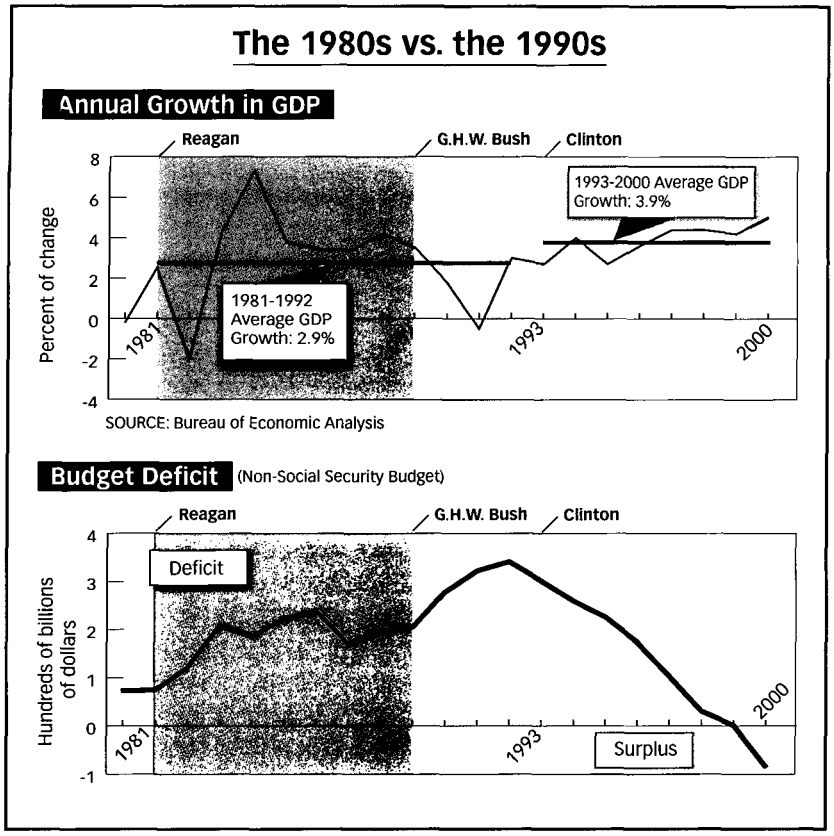

FORWARD OR BACKWARD? The Clinton years saw a sharp rise in average gross domestic product by a full percentage point (top chart). Meanwhile, deficits plunged for the first time since the Reagan era, turning into surpluses (bottom chart).

of citizens from the top to the bottom of the economic scale. The results were the longest sustained economic boom since the 1960s, the disappearance of federal budget deficits, the creation of the the first mass upper-middle class in human history, the re-emergence of U.S. global economic leadership, and finally, the first major increases in real incomes for lower- and middle-income Americans in nearly three decades.

Putting politics aside, which decade's policies and results would any intelligent observer prefer?

But a return to 1980s policies is exactly what the Bush administration and most congressional Republicans are proposing. Emulating Reagan's 1981 economic plan, the president is proposing income tax cuts aimed in no small part at lowering the top marginal rate on the highest earners (the targeting of relief to high earners is compounded by his proposal to repeal the federal estate tax). As in 1981, the Bush tax plan is being proposed as part of an overall budget that deliberately underestimates the revenue losses from tax cuts; deliberately overestimates the savings likely to be produced from future spending cuts, as yet unspecified; and deliberately subordinates long-term fiscal discipline and debt relief to a short-term obsession with cutting taxes.

While Bush administration officials are careful not to publicly embrace the discredited supply-side economic theory that cutting marginal tax rates "pays for itself" in higher growth and revenues, belief in supply-side economics remains strong among many conservative opinion-leaders and members of Congress who support the Bush plan. And the president has himself frequently advanced another staple of the 1980s argument for big tax cuts: the "starve big government" hypothesis that taking revenues off the table will avoid unspecified types of higher federal spending.

It would be bad enough if the consequences of following Bush's lead on fiscal policy were that the country would return to the budgetary and economic conditions of the 1980s. But it's potentially far worse than that, for three important reasons.

FIRST, the Reagan tax cut blitz occurred when the country had been mired in bad economic conditions for several years, with a recession following a period of double-digit inflation and interest rates. At least Republicans could then argue that existing economic policies had failed, and it was worth trying something new. But the Bush tax cut blitz represents a sharp departure from the most successful economic policies in a generation. The main short-term threat to the economy comes from a crisis of consumer

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and investor confidence that could turn a healthy slowdown from unsustainable growth levels into a serious recession. Moreover, the President is deliberately fanning these fears and undermining confidence in an effort to "scare up" support for his tax cut.

SECOND, just beyond the 10-year horizons of everyone's budget forecasts, the baby boom generation will begin to retire, creating a fiscal, and even a moral, crisis for the country as today's Social Security and Medicare surpluses turn into giant deficits. The Bush administration message that the only budget problem facing the country is how to dispose of projected surpluses ignores this fundamental reality. Yet the president's own agenda includes a partial privatization plan for Social Security that will incur roughly $1 trillion in transition costs, and he's also planning to raid Medicare payroll tax revenues to pay for a prescription drug benefit and help offset the cost of tax cuts. Finally, the administration is diverting surplus funds from payments on the national debt into tax cuts, which will directly weaken the fiscal condition of the country heading into the baby boom retirement crisis. Clearly, any success the administration achieves on its budget and tax priorities this year will directly undermine the ability of the country to cope with future retirement costs.

THIRD, the economy of the 1980s is long gone, replaced by a knowledge-driven global New Economy with very different characteristics and needs. One of the crowning ironies of the early stages of this year's tax debate is that the revenue projections the Bush administration is relying on in making the case for its tax plan are in turn based on bullish assessments of productivity gains attributable to the spread of new technologies throughout the U.S. economy. Yet the Bush agenda does little or nothing to promote these new technologies or to equip the American people to use them. Instead, administration economic policy is focused on old-fashioned business cycle management strategies in which productivity and real income gains are at most an afterthought.

Moreover, by directly attacking the progressivity of the U.S. tax code, the Bush team is failing to recognize the critical economic as well as moral importance of spreading the blessings of prosperity more broadly and "expanding the winners' circle" of Americans prepared to succeed in the New Economy. No economic idea is more thoroughly obsolete than the notion that economic growth is driven purely by the investment decisions of those at the top of the income ladder.

The key to the tax and budget debate this year will be the success or failure of Democrats and responsible Republicans to engage the American people in a broader debate about each party's vision of the country — its economy, its values, its priorities, and its future. New Democrats have a special obligation to champion expanded opportunity in the New Economy; mutual responsibility for the debts of the 1990s and the retirement IOUs piling up just ahead; and above all, the belief that these decisions must be made by Americans as a community that can transcend narrow self-interest or hostility to the common enterprise of government.

In promoting this kind of debate, New Democrats will have to overcome an administration that has so far been unwilling to admit the fundamental choices its agenda represents.

On the eve of President Bush's February 2001 address to Congress, focused on building support for his tax plan, a *Washington Times* front-page headline previewed the president's message as: "Bush To Tell Americans They Can Have It All." The *Times* got it exactly right. The Bush administration claims to offer the country an endless buffet of easy choices, with economic recovery, investments in education and health care, protection of Social Security and Medicare, and a $2 trillion-plus tax cut nestled comfortably together on the same plate. Such an offering will never work because it rests on an egregious exercise in fuzzy math.

This means Congress and the country face several tough choices this year, and one really big choice. We can go forward, or go back. ▣

"The Bush administration claims to offer the country an endless buffet of easy choices. Such an offering will never work because it rests on an egregious exercise in fuzzy math."

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Shaping the New Prosperity Agenda

We have an unparalleled opportunity to sustain the boom of the 1990s and to expand its benefits to all Americans.

by Sen. Joe Lieberman

The most important debate we face today is about our economy: how to maintain its health and handle the fall in the stock markets; how to calm growing investor anxiety; and whether to implement the tax plan that President Bush is marketing now as a cure for what ails us.

First, it's important to note that while the economy is in a slowdown, its fundamentals are strong and stable. The fiscal discipline of the 1990s, along with support for open markets and investments in human capital, has created a foundation that cannot be quickly eroded. This is no time for panic, but rather a time for perspective. Our future is full of opportunity — if we make the right and responsible choices. And the biggest question is, how do we make the projected budget surpluses work best for us? How do we take advantage of this extraordinary opportunity to strengthen our economy for tomorrow, to expand our prosperity for future generations?

The biggest threat to our economy is not the short-term shakeout we are experiencing but the long-term vision we are lacking. What we need now is not just a tax plan but a prosperity plan, a strategic blueprint for how to extend and expand our economic growth and how to widen the circle of opportunity for more Americans.

Unfortunately, that blueprint is not coming from the White House these days. The president has put forward a tax cut that was designed 15 months ago, in the midst of the Republican primaries, when one of his opponents, Steve Forbes, was promoting flat taxes. The Bush tax plan abandons fiscal responsibility and blithely spends — indeed, overspends — a projected surplus whose size six months from now is unclear, to say nothing of 10 years from now. It is a tax plan that gives the most to those who need it least and leaves little or nothing for making the kinds of investments that will secure and brighten America's future.

Sen. Joe Lieberman (D-Conn.) was the Democratic vice presidential candidate in 2000. He is a former chairman of the Democratic Leadership Council.

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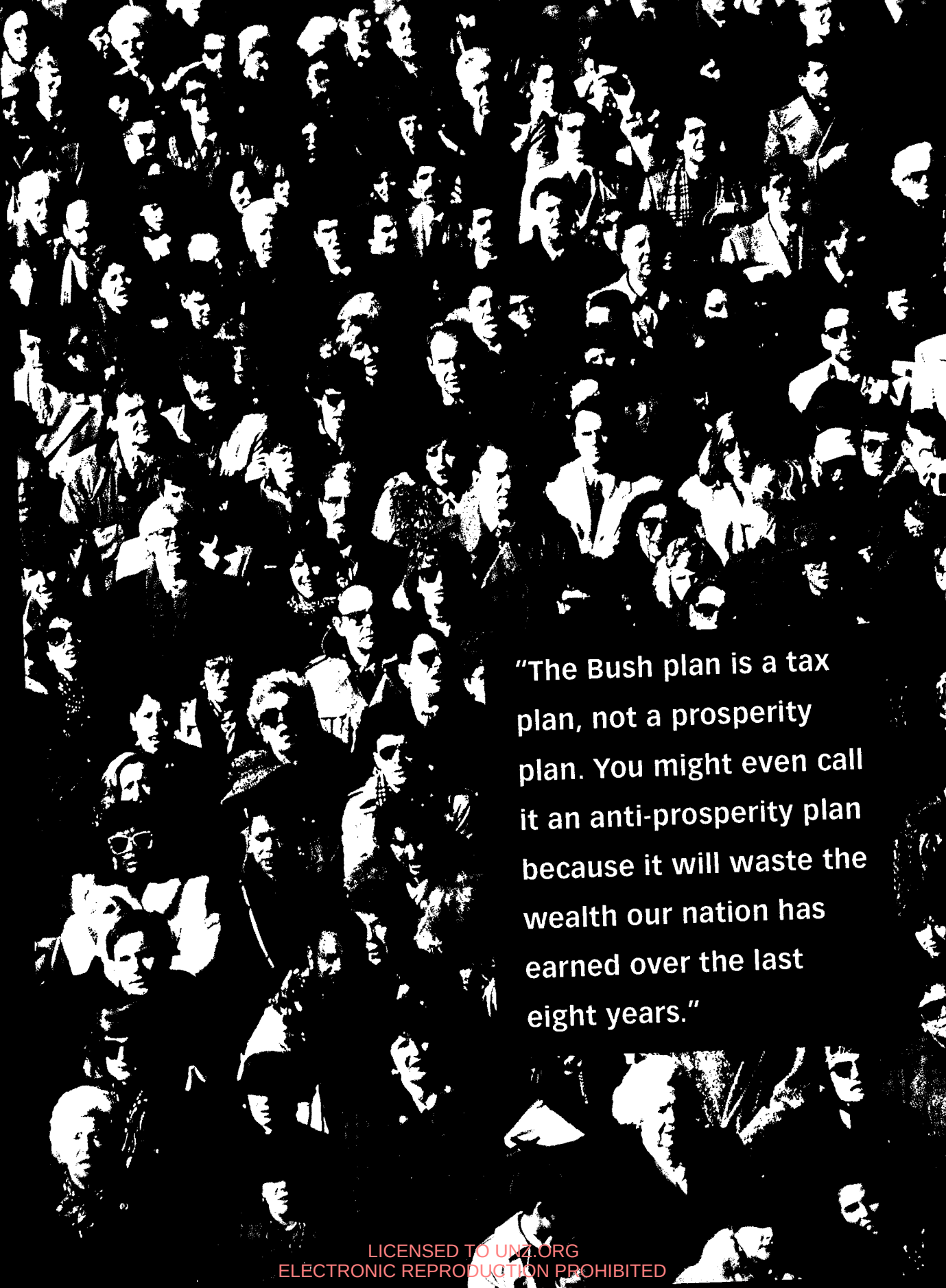
"The Bush plan is a tax plan, not a prosperity plan. You might even call it an anti-prosperity plan because it will waste the wealth our nation has earned over the last eight years."

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BUILDING OUR FUTURE: The Bush tax plan would squander the investment capital we need to secure a prosperous future for all American families.

The Bush plan is a tax plan, not a prosperity plan. You might even call it an anti-prosperity plan because it will waste the wealth our nation has earned over the last eight years and send us back down the road to debt, higher interest rates, and higher unemployment. The Bush plan cannot answer the big questions about what kind of country we want to be 10 years from now, because it does not ask the right questions. It lacks vision and therefore squanders this moment's opportunity.

Rather than pass a politically driven $1.6 trillion tax cut as the president wants, Congress should instead embrace a fair, fast, and fiscally responsible tax stimulus package. Economists tell us that it would take a tax cut of at least $60 billion to have a positive effect on our economy this year. Current estimates are that the federal government will have a surplus of about $100 billion at the end of this fiscal year — Sept. 30 — so we can safely afford a $60 billion stimulus. We should divide that $60 billion by the 200 million Americans who paid income or payroll taxes last year and send each one of them a $300 check as soon as possible. That's a tax rebate that can give our economy and our national confidence the kick start they need.

By contrast, the market turmoil of the last few months throws the frailty of the Bush administration's approach into stark relief. Just when financial markets need reassurance, the president has failed to provide it. In fact, his tax plan does nothing for the economy in the short term and it jeopardizes our fiscal stability in the long term.

If we are to seize this moment, we must have a clear vision and a long view of where we want to go and of how best to get there. We need a new approach, rooted in the old values of freedom, opportunity, responsibility, and community. What we need is a New Prosperity Agenda, based on fiscal responsibility, open markets, and wise investments that empower our citizens to succeed in the near term while guaranteeing their long-term economic security.

The primary goal of this New Prosperity Agenda is to protect, stimulate, and expand economic growth. Government's role is not to create jobs but to help create the environment in which the private sector will create jobs. A tax cut alone cannot do this — particularly a tax cut designed for political purposes, as President Bush's was. Government can help create the right context for the private sector by maintaining fiscal discipline in its own accounts and investing in and spurring on education and training, and scientific research and development, which are the seeds of an innovative economy.

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The Innovation Economy

The recent market tumult does not alter the fact that we are now witnessing an economic transformation of global proportions, from an industrial economy that produced goods to an Innovation Economy that produces ideas and information. And those ideas in turn help us produce goods even more efficiently. The productivity increases of the last decade have been astonishing. America's economy is the strongest in the world, by far, and will remain so if we in the federal government don't mess it up by being fiscally irresponsible and by failing to invest in our future growth.

Let's remember that for two decades, from 1973 to 1993, we were mired in a cycle of low growth, low productivity, persistent inflation threats, and high unemployment. All that changed with a series of technology innovations made possible by widespread use of the microchip.

Today millions of people are communicating and doing business over the World Wide Web, buying and selling goods and services with a click of a mouse, checking stock quotes and currency rates on the screens of their cellular phones, sending digital strategic plans to business partners halfway round the globe in the space of an instant, and harnessing the pinpoint precision of a satellite to tell them where they might locate a spare part. Despite the problems dot-com stocks are having on the markets today, the reality is that efficiencies from the Internet remain a powerful economic engine for ongoing productivity gains in the future.

Productivity is the story of the 1990s. By the early 1990s, the fundamentals of our economy had changed, bringing us as close to true full employment as we've ever been. Growth surged after 1995 at a pace not seen since before the oil crisis of 1973, and for almost a decade now, we have maintained an annual productivity level equal to the post World War II economic boom. Between 1990 and 1998, 5.3 million new businesses were launched and 22 million new jobs created. And unemployment declined for all racial and ethnic groups to 4.2 percent, among the lowest rates ever in the industrialized world. It's as though we've been in an open field run for the past eight years. How did we do it? Fiscal discipline. Low debt and therefore low interest rates enabled the private sector to invest in training, innovation, and capital equipment, while the public sector invested in research and development, and education and training.

This dramatic progress didn't come without adjustments. People must work harder to keep pace with the changing demands of the workplace. Education is no longer a youthful opportunity; it is a lifelong necessity, as new technologies demand new skills. Employees must create their own nest eggs for retirement because they either fear Social Security will not be there for them or they know it will not be enough. Fifty-three percent expect to rely on their own savings in their old age, rather than on government benefits. The days of the gold watch at retirement have been replaced by 401(k)s and Individual Retirement Accounts.

During the 2000 presidential election, I visited a firehouse in Florida. Over breakfast with the firefighters, I asked what they talk about on a typical morning. Their answer surprised me. They said they talk about the stock market and their personal portfolios. Now *that* is a revolutionary change. In the 1980s, approximately 20 percent of the population invested in the stock market. Today, more than 50 percent does. This means that many more Americans have assets at risk in a downturn like the one we are in today. But it also means that more assets are available for growth and future security.

The Pieces of a New Prosperity Agenda

All this was part of widening the winner's circle. To continue this trend, we need a New Prosperity Agenda that has three major parts: reduction of the national debt; investment in the building blocks of the Innovation Economy; and a reasonable and progressive tax cut. We should invest one-third of the projected surplus in each of these.

1. We must begin with a fiscally sensible budget that places the highest priority on paying down the national debt. To continue paying off America's debt, now $3.4 trillion,

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we must set aside at least one-third of the projected surplus

One of the most enduring lessons of the last 20 years is that debt reduction pays off. Our surplus now gives us a historic opportunity to be debt free by the end of this decade. That will keep interest rates down on home mortgages, car loans, credit card bills, and student loans. Low interest rates also cut the cost of capital available for business innovation and expansion. If the surplus does not turn out to be as large as we hope it will, then we will not have committed to obligations that might drive us into deficit spending again. The funds we set aside for debt reduction will become a rainy day fund.

2. The next step in the New Prosperity Agenda is to invest in the building blocks of the Innovation Economy: education, scientific research and development, and a robust private sector. Another one-third of the projected surplus must be set aside for this purpose.

"We cannot spend money we don't have. We must pay our bills and make investments for our future before we take vacations."

Skills and learning not only drive productivity growth but increasingly determine individual opportunity. The workers of the Innovation Economy must be fluent in the language of information. They must be literate in technology. By 2006, almost half of the U.S. workforce will be employed in industries that are either big producers or intensive users of information technology.

In recent years, we have experienced serious skills shortages. And while the current economic slowdown might temporarily ease the demand for talent, in the long term, our training rates for engineers, scientists, technologists, and skilled and educated workers are alarming. Innovation demands trained innovators. So we must concentrate our resolve and our resources on changing the way we teach and train our labor force.

We need to start at the beginning by passing the 3-R's legislation several Senate Democratic colleagues and I have introduced to reform our K-12 system.

This legislation gives more flexibility to local educators and, in return, demands results from them in educating our children.

We should also give parents, workers and employees tax credits to make lifelong learning easier.

The expenses of employers investing in remedial education should be offset with a new education tax credit. And we should support tax relief for low- and middle-income families struggling to pay the cost of their children's college education and their own mid-career retraining.

The role of scientific innovation is also central to a Prosperity Agenda. The story of the American economy is the story of scientific breakthroughs leading to economic growth. Yet President Bush's budget outline starves three of the greatest generators of innovative ideas — the National Science Foundation, NASA, and the Department of Energy. For instance, the National Science Foundation is slated for a 1.3 percent funding boost, which is effectively a cut, since that increase is less than the rate of inflation. Dr. Allen Bromley, who was the previous President Bush's White House science adviser, calls these proposed cuts a "self-defeating policy... no science, no surplus," he wrote in *The New York Times.* "It's that simple."

3. A Prosperity Agenda must also contain a tax package with a purpose. And that purpose must be, above all else, to stimulate economic growth, to raise the tide that lifts the lot of all Americans. The final one-third of the projected surplus should be dedicated to tax reductions, some to reward working families and the rest to business tax cuts that stimulate economic growth and new jobs. In the spirit of the Innovation Economy, we should look to tax incentives that will spur the drivers of growth: innovation investment, a skilled workforce, and productivity. We should:

- Lower the capital gains rate.
- Eliminate capital gains *entirely* for long-term investments in start-up firms.
- Give tax credits to small firms to invest in information technology.
- Adjust depreciation schedules in the tax code to more accurately reflect the lifetime of information technology and other investment products.
- Offer a tax credit to build a broadband infrastructure.

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• Make the R&D tax credit permanent and more accessible to small businesses and start-ups, while encouraging more cooperative research.

If we are successful in building on our prosperity, we will be able to guarantee the future of Social Security and Medicare. Strengthening Medicare will require more resources, not less. Yet the president's tax cut reaches into the Medicare surplus, leaving scant hope for modernization, including the meaningful prescription drug benefit he promised.

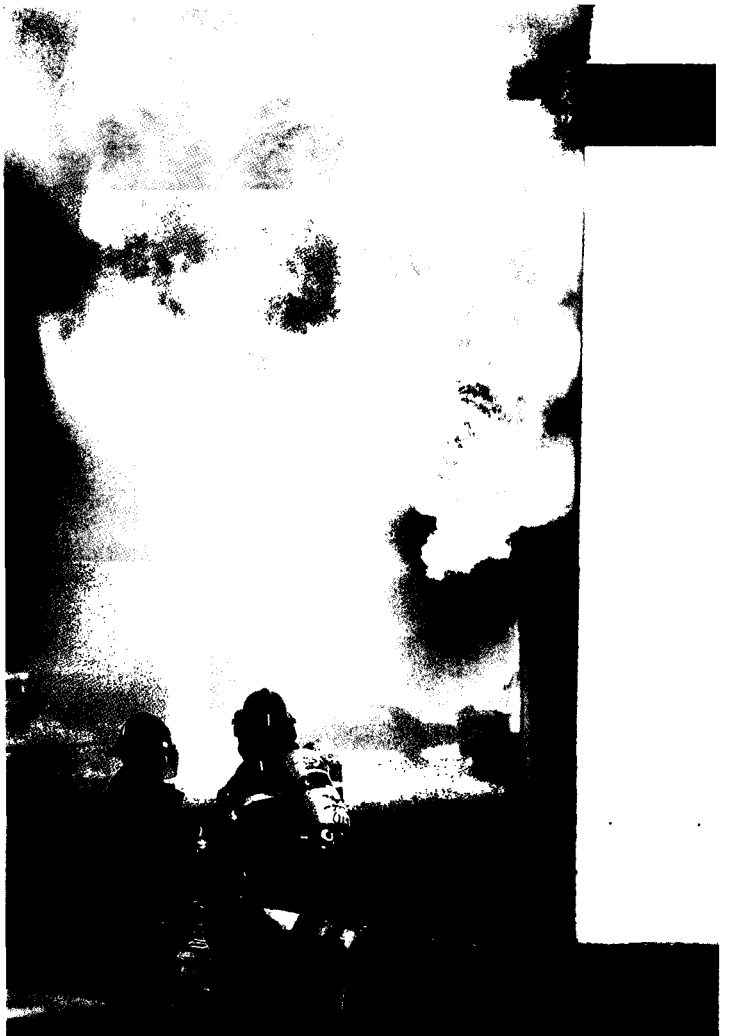
Social Security is still the foundation of old-age support for millions of Americans, even as Innovation Economy workers rely more and more on personal savings for retirement. We must meet our obligations to our retirees, but we must also seek reforms that will make their retirements more secure.

Finally, a long-term New Prosperity Agenda also must be attentive to short term challenges.

The inherent strength of our private sector will do the most to bring our economy out of its dip, but Federal Reserve monetary policy and federal government fiscal policy can help. In March, the administration and its congressional allies acknowledged that the $1.6 trillion Bush tax cut plan would give nothing back to taxpayers this year and little next year. Now, they want to add a one-year economic stimulus to their larger plan and apparently pass the two together. But that would hold the help our lagging economy needs now hostage to a drawn-out congressional debate about the long-term Bush plan. Help would come too late.

Ten years from now, we will be judged by the decisions we make today. People will ask, did we fully understand the awesome changes taking place in our economy and in our society? Did we direct our unprecedented surpluses into investments with the greatest returns? Did we give our workers the tools they need to seize the opportunities an innovation economy offers? And were we guided by those proud American values that have brought us this far?

If we keep that perspective in view, we'll have a good shot at answering those questions affirmatively. But we must exercise discipline and follow a true Prosperity Agenda. As in our daily lives, we cannot spend money we don't have. We must pay our bills and make investments for our future before we take vacations. A short-term economic stimulus to help lift us out of this economic slowdown has to be followed by business tax credits and smart investments to sustain long-term growth. Only then can we be confident of our ability to provide comfort and security to our parents and a bright future for our children. ■



EVEN FIREFIGHTERS OWN STOCK: Today, more than 50 percent of Americans are stockholders. During the 2000 presidential campaign, Sen. Lieberman asked a group of Florida firefighters what they talk about on a typical morning. Their answer? The stock market.

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Keep growth alive!

Maintaining fiscal discipline is the key to sustaining the economic success of the last eight years.

by Lawrence H. Summers

Americans are blessed with an extraordinary opportunity. Even though the U.S. economy is now slowing, major budget surpluses, projected for years to come, provide the means to address the economic challenges our nation still faces. Rather than squander the surpluses, we vitally need a strategy to build on the economic success of the last eight years that will prepare us for the future. Such a strategy should include four components: maintaining a prudently managed budget; committing to an open global economy; building a sound regulatory framework for the New Economy; and working to include everyone in our nation's prosperity.

1. **Maintaining a prudently managed budget.** Fiscal discipline has been critical to our economic success of the last eight years, and it will be critical in the years ahead, especially as we tackle the demands of an aging society. It would be a significant error to threaten our fiscal discipline by enacting an excessive tax cut.

In the past decade, the American economy underwent a transformation and became the envy of the world. As the 1990s began, unemployment and interest rates were high, and confidence in the economy was low. Key U.S. businesses seemed to have lost their competitive edge.

Today, all that has changed. Even with the current slowdown, the U.S. economy is the world leader. Unemployment is still low, and wages across the income spectrum have risen.

Many factors contributed to the transformation of the U.S. economy. First and foremost, of course, was the hard work and entrepreneurial spirit of American workers, farmers, and businessmen. Technological advances gave birth to new businesses and new ways of conducting business, which helped productivity to increase.

Thanks to fiscal discipline, we moved from a vicious cycle of rising public debt, higher interest rates, lower private investment, and slower productivity growth to the opposite: a virtuous cycle of lower deficits and eventually higher surpluses, debt reduction, low interest

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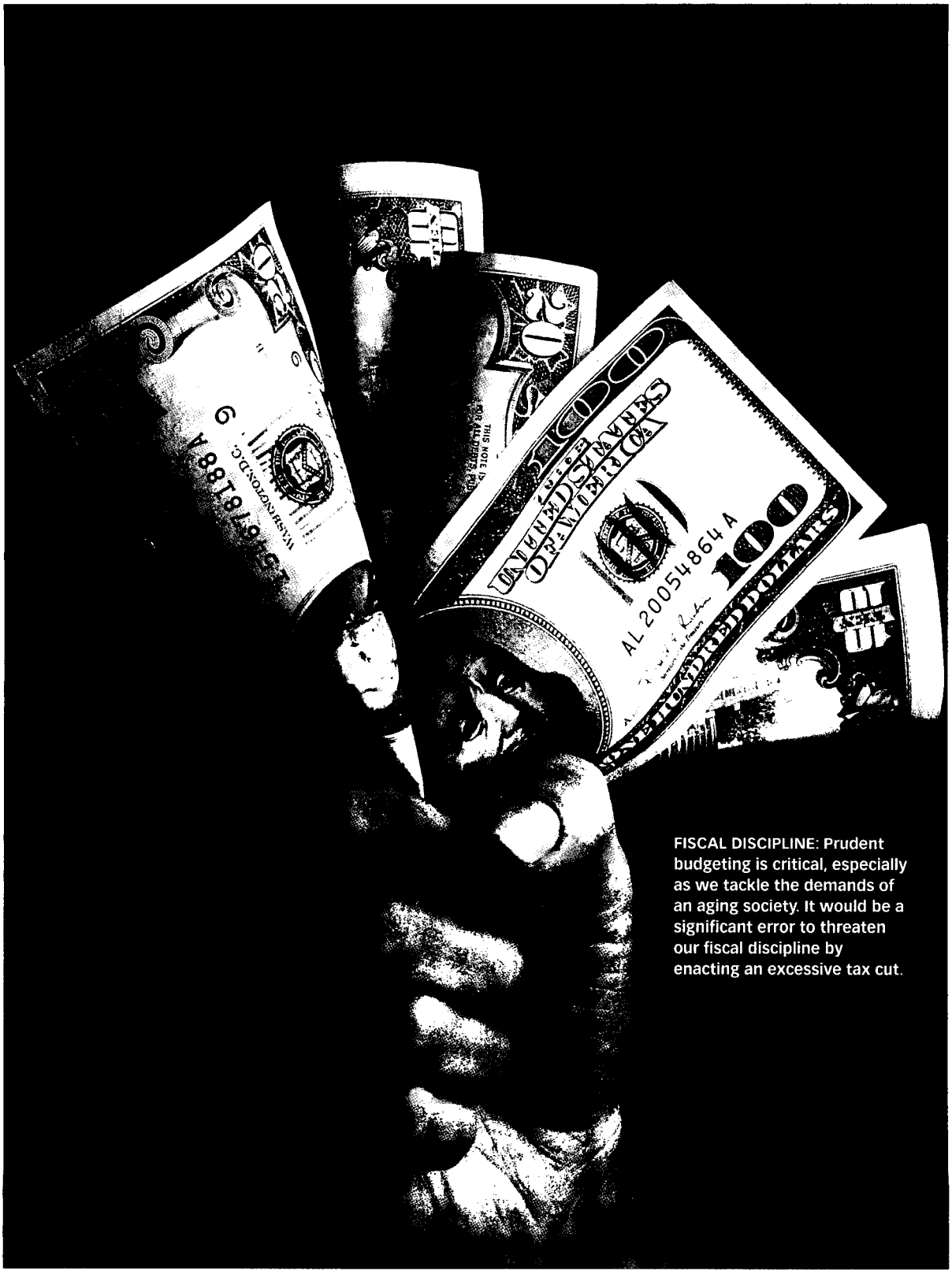

FISCAL DISCIPLINE: Prudent budgeting is critical, especially as we tackle the demands of an aging society. It would be a significant error to threaten our fiscal discipline by enacting an excessive tax cut.

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"A major tax cut whose benefits are tilted toward upper income individuals is inherently unfair.... Tax cuts should be targeted toward those who most need the relief — lower-income families and individuals."

rates, increased private investment, and greater productivity growth. Because of this prudent budget management, roughly $2.5 trillion that would otherwise have been absorbed by government borrowing was instead invested in making America more productive.

Debt reduction is essential to sustaining our economic expansion and for laying the groundwork for a healthy economy for years to come. An excessive tax cut on the order of $1.6 trillion would threaten our ability to do exactly that.

Such a huge tax cut is fundamentally flawed for three reasons. First is the possibility that it will consume the surpluses at the expense of other priorities. Although the projected surpluses look enormous right now, fiscal forecasts are always uncertain. In fact, the Congressional Budget Office says that its most recent budget surplus projections could have a range of uncertainty of some $600 billion *in either direction* over the next five years, and $3.5 trillion over the next 10 years. With an excessive tax cut, we risk returning to budget deficits, putting at risk our ability to pay down the debt and to pay for the demands of an aging society.

Second, a major tax cut whose benefits are tilted toward upper income individuals is inherently unfair. This is especially true if the tax cuts bring a return to deficits, which could cause a reduction in government benefits, disproportionately hurting lower income individuals who depend more on those benefits. Tax cuts should be targeted toward those who most need the relief — lower-income families and individuals.

Finally, some have made the case that tax cuts are necessary to provide a fiscal stimulus for a slowing economy. However, a plan that "back loads" many of the tax cuts, not implementing them for years, would have an effect that is the reverse from the one intended: The fiscal stimulus would come too late to prevent a slowdown now, yet the upward pressure on interest rates would come much earlier.

As an undergraduate in the 1970s, I was taught that expansionary fiscal policy — higher budget deficits — could boost economic performance, as deficits were considered a useful stimulus to growth in an economy producing well short of its capacity.

This Keynesian idea still is the right prescription for certain economies at certain times. But over the last several decades, there has been a major revision in economic thinking about fiscal policy. Now, economists place much greater emphasis on the importance of supply factors for long-term growth. They believe that by crowding out investment, budget deficits can slow productivity growth. In an economy close to full capacity, excessive stimulus can even increase inflationary pressures, raise risk premiums, and lead to higher interest rates.

In addition, financial markets have become more forward-looking and more sensitive to changes in fiscal policy. As a result, dramatic budget changes are more likely to provoke an aggressive and immediate offsetting response from financial markets. This was powerfully demonstrated by the stimulative impact of deficit reduction in the 1990s, as increased investment demand resulting in a lower cost of capital more than outweighed any demand losses to the economy that resulted from lower government spending.

Thus, it is vital that we stay on the course of paying down and eventually eliminating the debt. Like tax cuts, reducing public debt delivers substantial direct benefits to the pocketbooks of American families. It lowers the burden of future payments on interest and principal and it puts downward pressure on long-term interest rates.

But with medical advances lengthening lifetimes and the impending baby boom retirement certain to place considerable fiscal pressures on the nation, the imperative for fiscal discipline is all the greater. We must make sure both the Social Security and Medicare trust funds are in sound fiscal shape for these challenges and that both trust funds are placed in a "lockbox" where they cannot be raided for tax cuts or other purposes.

2. Committing to an open global economy that works for people. The second part of a successful economic strategy must be an open global economy, one that will

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benefit all people. Increased global integration brings enormous opportunities for American workers, farmers, and businessmen. Increased trade and international investment helps create high-paying jobs, improve economic efficiency, and raise productivity. But global competition also carries with it challenges, such as job displacements. Many are concerned that increased trade comes at the expense of the environment and workers' rights.

Still, we need to continue to press for more open markets, so that U.S. businesses and farmers can sell their products in more markets overseas, while working with other countries to protect the environment and the rights of workers. The free trade agreement reached with Jordan by the Clinton administration demonstrates that trade agreements can include environmental and labor rights provisions without sacrificing the benefits of increased trade.

3. Building a sound regulatory framework for the New Economy. We need a framework that will create an environment in which innovation can flourish and in which we can maximize the benefits of technology and globalization while minimizing the risks. Such a framework should support, not supplant the market. It should not be a heavy hand that tries to dictate outcomes, nor an invisible hand that assumes unfettered markets will ensure optimal outcomes, but the helping hand of government.

We must recognize that technology and globalization offer considerable benefits for American workers in terms of increased productivity, higher economic growth, and the creation of high-paying jobs. However, we must also recognize that these developments have a dark side. Increased flows of capital around the world, for instance, help foster economic efficiency and promote growth, but also make it easier for criminals to launder money and evade taxes. A critical tool for combating tax evasion is the Organization for Economic Cooperation and Development's effort to focus a spotlight on countries that tolerate or even encourage tax evasion. The OECD's initiative is important in setting standards, and it would be a great mistake not to support its efforts.

We need to support the market system as it evolves. But we still have a responsibility to consider the consequences of the emergence of new technologies, such as easy access to hate speech or pornography on the Internet, or ethical issues raised by cloning.

4. Working to include everyone in prosperity. There are still far too many who have not benefited from our dynamic economy, and we need to equip them with the tools to do so. We have begun to make progress — unemployment has come down sharply in low-income urban and rural areas, for example — but we cannot afford complacency.

At a time when the economy has people looking for jobs and jobs looking for people, it is important to encourage people to work. That means expanding the Earned Income Tax Credit, building on the welfare-to-work tax credit, promoting child care so women can work, and expanding capital access in distressed economic areas that have large pools of unemployed people. Finally, it is important that we invest in education and training, which are critical to future productivity. In a period of national prosperity it is simply wrong that there are schools where children have to eat lunch in shifts beginning at 9 a.m. and where the electric system is too old for children to safely plug in a classroom computer. With the overriding importance of education, it is folly for us to allow such situations to continue.

The U.S. economy has been in the longest expansion in its history. Expansions sometimes end abruptly and catastrophically, as in 1929; sometimes they pause, are refreshed, and continue, as in 1967, 1986, and 1995. Maximizing the chance that our current slowdown is merely a pause and that the economy is about to be refreshed, rather than a catastrophic end to an extraordinary period of prosperity, is what making the right choices is all about. If we abandon the fiscal discipline that has served us so well or fail to include everyone in our nation's prosperity, we will have missed an opportunity that we may never see again. ■

"There are still far too many who have not benefited from our dynamic economy, and we need to equip them with the tools to do so."

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FUZZY MATH: President Bush's tax and budget figures, as reflected in his talking point cards, sound good. But they don't add up.

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The Ant and the Grasshopper

The nation's greatest priority is *not* cutting taxes as much and as fast as possible — but rather preparing for the high costs of the aging of America.

by Jeff Lemieux

Everyone is familiar with Aesop's fable of the ant and the grasshopper. All summer long, the ant toils to store grain for the coming winter while the grasshopper sings and cavorts. When winter comes, the ant feasts and the grasshopper suffers.

President Bush has presented Congress with a "grasshopper" budget: It advocates living for today instead of preparing for tomorrow. Despite the president's arguments to the contrary, America's greatest priority is *not* cutting taxes as much and as fast as possible. Rather, it is to put our economy and federal budget on the best possible footing to shoulder the immense costs of a steadily aging population. The only responsible way to meet that challenge is to devote a significant share of today's surplus to debt reduction and the huge up-front costs of entitlement reform. Yet the president would irresponsibly squander the surplus on his tax plan.

In a sense, the federal budget is in a trough between two waves. We've just crested a wave of deficits accumulated during the 1980s and early 1990s. Now, we find ourselves in a period of surpluses that were built during the Clinton era on a foundation of fiscal discipline, deficit reduction, and private investment and innovation. But we know that an even bigger wave of deficits will hit us when the baby boom generation begins to retire in 2011.

Until now, the prevailing economic wisdom has been to use the surpluses to "save Social Security first" — in other words, to forgo big tax cuts and spending increases and use the surpluses instead to pay down the nation's $3.4 trillion debt. Paying down the debt lowers interest rates and boosts the economy, and it also puts the government's finances in the best possible shape to weather the approaching demographic storm.

Of course Americans aren't going to say "no thanks" to a tax cut if one is offered. And the nation can, indeed, afford a responsible tax

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"We should hold government spending to a reasonable rate of growth and thereby continue to pay down the national debt. Reducing the national debt is both good economic policy and solid preparation for the future."

cut of the type outlined elsewhere in this issue *(see story, page 36)*. But when you ask Americans what's the best use for the surplus, by overwhelming margins they say paying down the nation's debts and securing Social Security, Medicare, and other future obligations. Tax cuts rank way down on their list of priorities *(see Penn's Poll, page 48)*. Congress should heed the American people's choices.

Calm Before the Storm

Americans are wary of huge tax cuts for good reason: They know the nation has yet to provide for the baby boomers' retirement. Although its impact should not be described in apocalyptic terms, the aging of America will almost inevitably force profound adjustments in U.S. budget policy.

The current decade is the calm before the storm. Between 2000 and 2010, the cost of entitlement programs (principally Social Security, Medicare, and Medicaid) will average 10 percent of the nation's gross domestic product (GDP). Since federal tax revenues generally average about 20 percent of GDP, that leaves another 10 percent — roughly half the budget — to cover the cost of everything else the federal government does (defense, social programs, research and development, interest on the debt, and so on).

All things being equal, from 2011 on, the share of GDP devoted to entitlements will begin to rise — to 12 percent by 2015, 15 percent by 2025, and more than 17 percent by 2030. Social Security's share will grow from 4 percent in 2010 to 6 percent in 2025. During the same period, Medicare's share will rise from 3 percent to 5 percent, and Medicaid's (which covers nursing home care for poor seniors) from just under 2 percent to 3 percent. Absent big future tax increases or reforms that slow the growth of entitlement spending, there will be little money left to pay for other government functions.

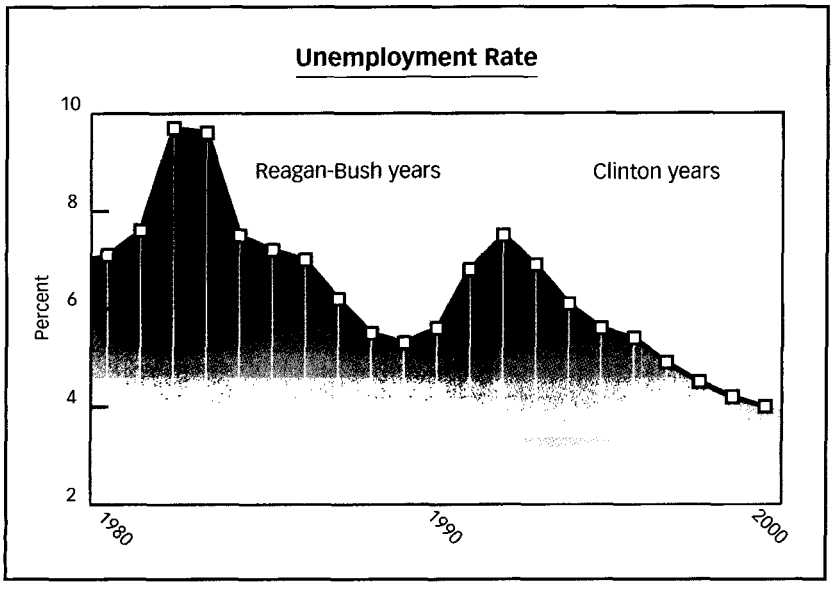
Such projections, of course, are uncertain. For instance, it is especially hard to predict future health costs. But virtually no one disputes the general demographic and budgetary trends — upward.

Meeting the Challenge

The nation must do two things to prepare for the baby boomer retirement.

First, we should hold government spending to a reasonable rate of growth and thereby continue to pay down the debt. That would lower interest rates, boost economic growth and productivity, and put the nation in a strong economic and financial position to face rising entitlement costs.

Reducing the debt is both good economic policy and solid preparation for the future. The switch from budget deficits to surpluses during the 1990s freed hundreds of billions of dollars for private investment, which paid enormous economic dividends. Much of that investment spurred the development of new technologies that dramatically raised workers' productivity and incomes. As a result, real annual economic growth during the decade averaged about 4 percent, much higher than economists had previously considered possible. The unemployment and



BENEFITS FOR ALL: The Clinton prosperity policies reached workers at all levels, driving unemployment to a historic 30-year low of 4 percent.

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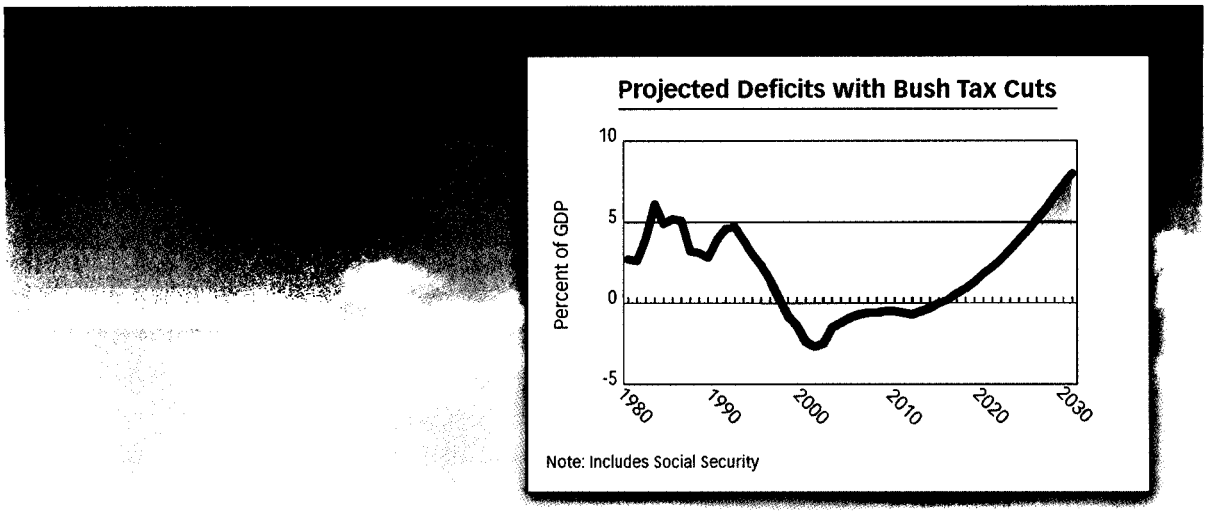

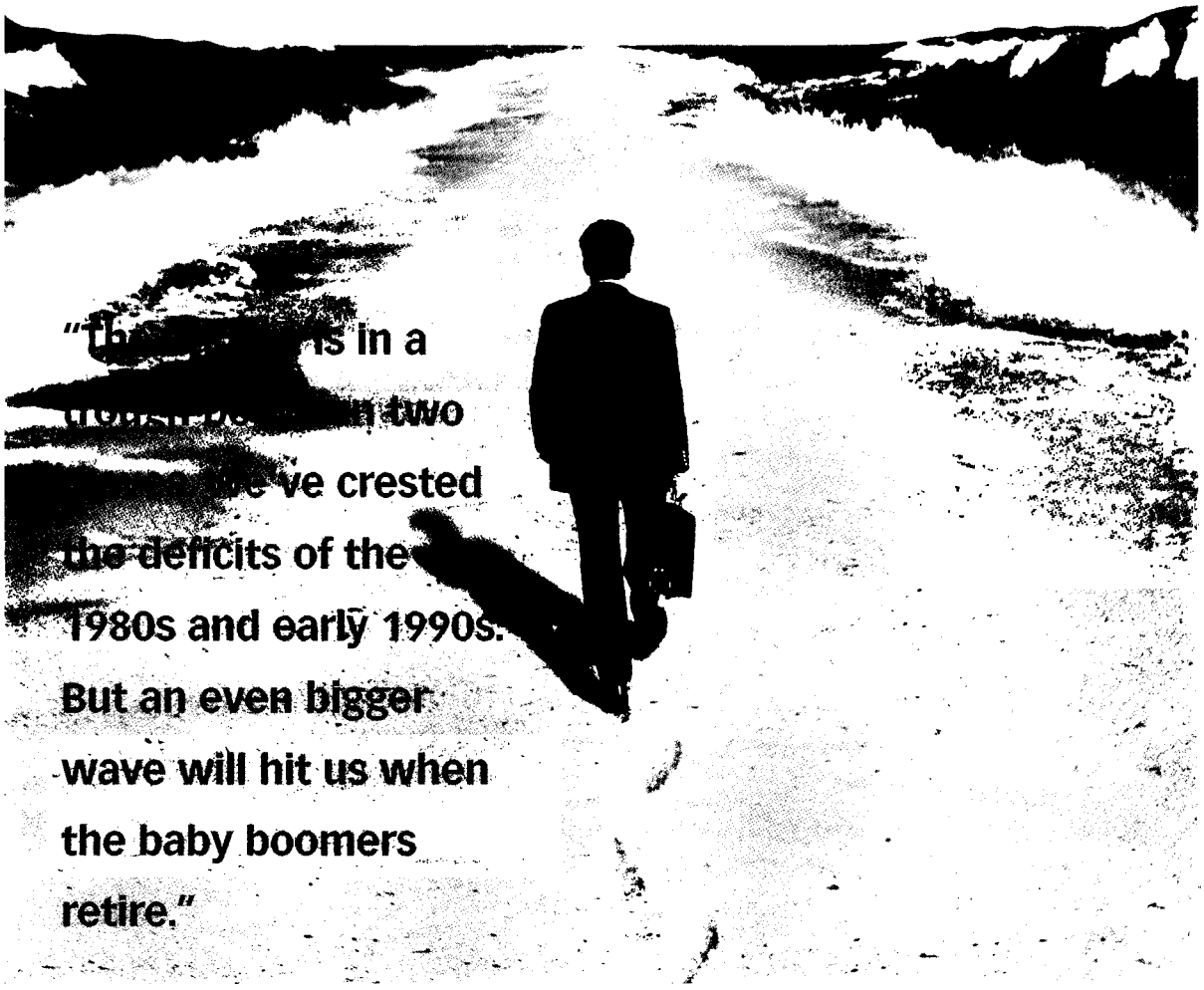

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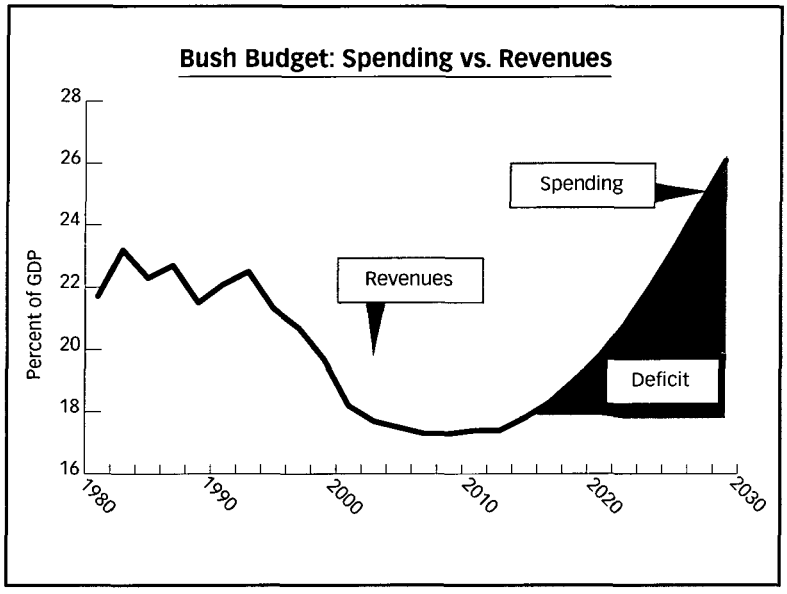
poverty rates also fell to their lowest levels in decades.

Second, we should reform entitlements to help prevent future budgetary imbalances. Make no mistake: Reform will be very expensive. Most Social Security reform proposals would spend huge sums over the next several years to build up personal retirement accounts. The accounts are designed to bolster the savings of future retirees who would otherwise face reduced benefits. During his presidential campaign, Bush proposed spending $1 trillion over the next 10 years to create such accounts. To win even a modicum of Democratic support for his plan, the president almost certainly will have to add an additional $200 billion to $500 billion to bolster the accounts of low-income workers and match their personal retirement savings.



DEFICITS REDUX: Under Bush's budget, federal spending as a percent of GDP would overtake revenues around 2015 and continue rising.

Blowing the Surplus

How the Bush budget and tax proposal leaves us with nothing

Projected 10-year surplus:	(in trillions of dollars)
■ Social Security trust fund	$2.5
■ General revenue & Medicare	3.1
The Bush budget eats up the surplus:	
■ Social Security trust fund	$ - 1.3
■ General revenue & Medicare	- 3.1
The depressing result:	
■ Social Security trust fund	$1.2
■ General revenue & Medicare	0

SOURCE: Progressive Policy Institute

Note: For these calculations, we assume the Bush plan includes;

1. Tax cut ($1.6 trillion)
2. Growth of 4 percent in defense and domestic spending
3. Fix alternative minimum tax ($195 billion)
4. Two percent "carve out" of Social Security payroll tax ($1 trillion)
5. Breaux/Frist II Medicare proposal ($250 billion)

According to the Congressional Budget Office, if the economy continues growing at a strong pace, if we do not cut taxes, *and* if government spending remains under control, between 2002 and 2011 the general revenue surplus will total $2.7 trillion, the Social Security surplus will total $2.5 trillion, and the Medicare Part A (i.e., hospital insurance) surplus will total $400 billion. But those are three very big "ifs."

Simply put, there is no responsible way to resolve the baby boom retirement problem without devoting a major share of *all* of those surpluses to debt reduction and the transition costs of entitlement reform. Here's the best approach: We should use the Social Security surplus for debt reduction, and we should reserve at least $1 trillion of the general revenue surplus for the transition costs of entitlement reform.

Bush Spends Most of the Surplus

Bush's budget presumes that the surpluses are so large that we can have it all: huge tax cuts over the next 10 years, a dramatically reduced national debt, and still money left over for entitlement reform's large up-front costs. Unfortunately, his numbers don't add up. Even under generous assumptions, Bush's budget would gut the general revenue and Medicare surpluses and cut the Social Security surplus by more than half. It would leave too little money for debt reduction and meaningful entitlement reform.

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Here are the specifics. First, give Bush the benefit of the doubt and assume that his tax cuts would cost $1.6 trillion as he often states, even though recent estimates from Congress's Joint Committee on Taxation indicate a far greater revenue loss. Second, assume that Bush will persuade Congress to hold annual spending increases for defense and domestic programs to 4 percent, which would be quite a feat given recent congressional spending patterns. Third, add $1 trillion to the president's budget to pay for his Social Security reform plan, which would shave 2 percentage points off the payroll tax to create personal retirement accounts; and $250 billion for Medicare reforms based on Bush-endorsed legislation recently introduced by Sens. John Breaux (D-La.) and Bill Frist (R-Tenn.) Frankly, those sums for Social Security and Medicare reform are far too low to attract a critical mass of support from Democrats and retirees. Finally, add $195 billion to the president's budget to partially fix the alternative minimum tax *(see story, page 45).*

Even under a best-case scenario for Bush, the bottom line would be stark: no general revenue and Medicare surpluses, less than half the original Social Security surplus, and half-baked debt reduction and entitlement reform.

Making Reform Progressive

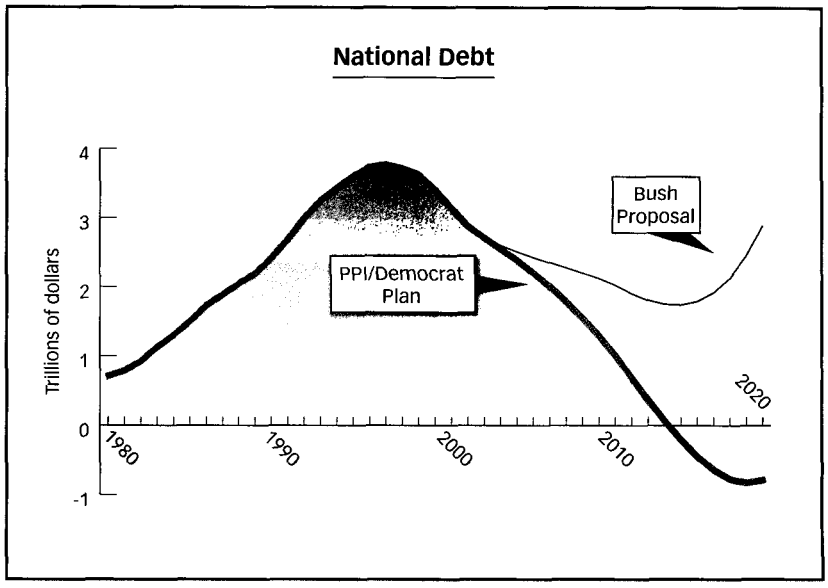
By spending the surplus on tax cuts, President Bush would make Social Security and Medicare reform far tougher to achieve. If he doesn't have the money to make reform truly progressive and empowering, Bush can count on Democratic opposition.

There is a strong consensus in Washington that entitlement reform should not harm current retirees. The generation that grew up during the Great Depression, fought in World War II, and built the postwar mass economy should have its retirement promises honored in full, no questions asked. At the same time, there is another growing consensus that the baby boom generation and those that succeed it would be better served by modernized entitlements. Even current retirees deserve more options: They too should be able to choose between old-fashioned entitlements and new alternatives.

There are many win-win possibilities in entitlement reform. Medicare reform based on competition, for example, offers the possibility of both reduced spending growth and better benefits, especially for the poor. Adding personal accounts to Social Security and subsidizing them strongly for low-wage workers would help such workers build a nest egg to supplement their benefits. Non-subsidized accounts, meanwhile, would cushion the blow of reduced benefits for high-wage workers.

In any case, all of the win-win possibilities for entitlement reform will be expensive. That's why Bush's bloated tax cut is so irresponsible. With his grasshopper budget, the president is failing to prepare today for the needs of tomorrow. He would squander the funds we need to make progressive entitlement reform possible. Rather than live by the wisdom of the ant, he's consigning future retirees — and our children — to the lot of the locusts who were given a fair-weather reward, and weren't prepared when winter came. ■

■ *ALL CHARTS are based on Progressive Policy Institute projections. The PPI/Democrat plan includes a 10 percent payroll tax credit or a flat $300 tax credit to all taxpayers (see page 36).*



WRONG DIRECTION: Under Clintonomics, the national debt has been falling and could reach zero by 2015. But under Bushonomics, with its radical tax cut, the national debt would curve dangerously upward again.

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Alive and kicking

Rumors of the New Economy's demise have been greatly exaggerated.

by Robert D. Atkinson

Was the New Economy a flash in the pan? Or, even worse, a myth spun by an over-imaginative media? After a decade of superb economic performance, are we doomed to return to the dismal days of the 1980s or, more ominously, of the 1930s?

To paraphrase Mark Twain, reports of the New Economy's demise have been greatly exaggerated. The New Economy is here to stay. It will lead to even faster productivity and income growth, but only if policymakers cast off the outmoded doctrines of Keynesian and supply-side economics. They must instead embrace growth economics — a combination of fiscal discipline, investment in the building blocks of the New Economy (research and skills), and support for open trade and robust competition.

President Bush's budget plan, by contrast, with its almost religious commitment to large, across-the-board cuts, runs diametrically counter to the precepts of growth economics. Contrary to the President's claim that his plan would save the economy from a recession, it would almost certainly have the opposite effect: slowing productivity and income growth over the next two decades.

The issue raised by the Republicans' neo-Keynesian economic approach is whether the New Economy is real; this question is at

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MORE THAN JUST A DOT-COM: The New Economy is about the transformation of all industries, the new ways business is done, and how people function in a service society. Its backbone, such as these servers and routers at Cisco Systems, is here to stay. Though Cisco's stock has taken a hit, its net sales for the quarter that ended Jan. 27 were $6.75 billion — an impressive 55 percent above the comparable period a year earlier. This is growth economics at work.

Investments

A New Economy investment agenda

Education, training, and technology are the foundation of growth in today's knowledge economy.

If the New Economy is to stay and thrive, the Bush administration needs to embrace growth economics rather than fight the battles of the last war with its Maginot-line supply-side defense. A key to new growth economics is investment in the building blocks of the New Economy — education, training, and technology.

Three decades of federal support for research has meant that companies had the fruits of the information technology revolution to invest in. In today's burgeoning knowledge economy, where high-tech firms now account for more than 6 percent of gross domestic product (GDP) and skill requirements are going up in most industries, federal investments in research, education, and training should be going up, not down — which is what would happen under the Bush economic plan with its costly tax cuts. The tight budgets caused by such cuts are an unacceptable excuse for failure to make targeted, critical, and ample investments. As virtually all economic research shows, technology and training investments have positive, tangible, and visible payoffs.

Yet President Bush's campaign commitments to support research were limited to increased funding for research at the National Institutes of Health and more money for weapons systems development at the Defense Department. In spite of the national shortage of skilled workers, Bush's campaign was silent on the federal role in workforce development. Now to afford his big tax cuts, it appears that Bush will actually be adding only very modest increases — or in some cases even cutting back — federal

Continued on page 27

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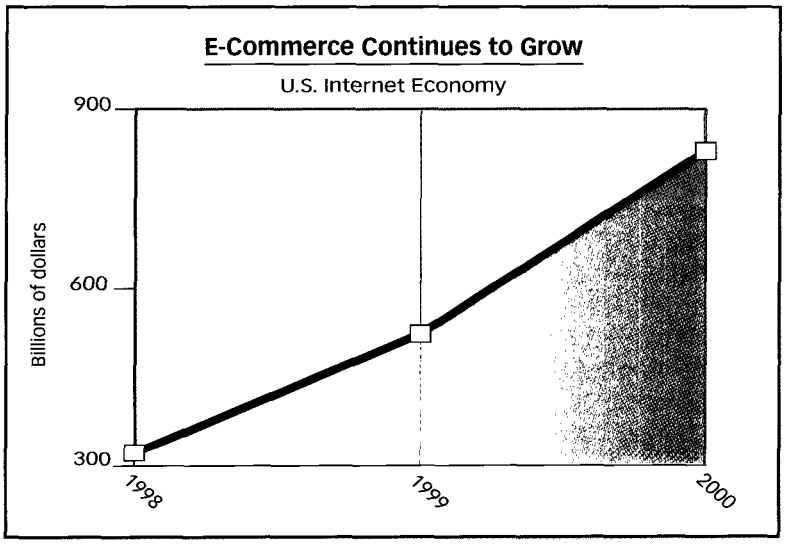
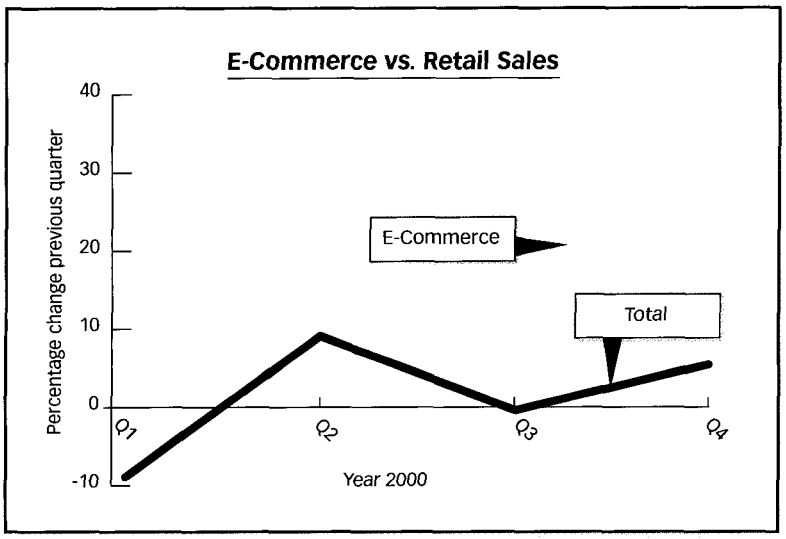
the very heart of today's fierce tax and budget debate. The Bush economic team's claim that its huge tax cut is critical to avoiding economic downturn and to boosting long-term growth rates rests on the premise that the New Economy was a chimera. But if their premise is wrong and the New Economy is indeed the real engine of our prosperity, then Bush's economic rationales are dramatically out of step with the new economic rules of the new economic era.



LIKE A ROCKET: Contrary to widespread belief, e-commerce is soaring, nearly tripling in the last two years of the 1990s.



EXPONENTIAL GROWTH: E-commerce sales grew seven times faster than all retail sales in the last quarter of 2000. They were 67 percent higher than one year before.

What's inspiring the pessimism that undergirds the Bush economic thrust is a spate of news reports that, taken at face value, suggest that the New Economy is crumbling. To be sure, the Nasdaq has fallen sharply, many dotcoms are going bust, and investment in information technology is down. When this news is conflated with the other negative economic indicators that surfaced in winter 2001, it is an easy but mistaken step to pronounce the death of the New Economy.

The fallacy of this leap rests on the belief that all the New Economy is about is the Internet and what investor Jim Clark and writer Michael Lewis dubbed the "next new thing." On the contrary, the New Economy embraces more fundamentally a profound transformation of all industries, the kind of transformation that happens perhaps twice in a century. The emergence of the New Economy is equivalent in scope and depth to the rise of the manufacturing economy in the 1890s and the emergence of the mass-production, corporate economy in the 1940s and '50s. As documented in the *New Economy Index* (Progressive Policy Institute, 1998), the New Economy represents a complex array of forces. These include the reorganization of firms, more efficient and dynamic capital markets, more economic "churning" and entrepreneurial dynamism, globalization, economic competition, and volatile labor markets.

The last time we experienced such profound change in the mid-20th century, Joseph Schumpeter wrote:

> *These [economic] revolutions periodically reshape the existing structure of industry by introducing new methods of production — the mechanized factory, the electrified factory, chemical synthesis, and the like; new commodities, such as railroad service, motorcars, electrical appliances; new forms of organization — the merger movement; new sources of supply*

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A New Economy investment agenda

Continued from page 25

investments in these areas. His budget proposal cuts funding for the National Science Foundation (in current dollars) and eliminates funding for the Department of Commerce's Advanced Technology Program. In direct contradiction to a bipartisan bill passed by the U.S. Senate in 1999 (S 2296) that supports doubling of the federal research budget over the next 11 years, the Bush budget proposes to increase all funding for science and technology 15 percent more slowly than the overall budget. That means that as a share of the GDP, federal support for science will actually decrease by 6 percent over a decade. Instead of adopting a $500 million digital government fund to reinvent and digitize the federal government — or even the $100 million fund he proposed during his campaign — President Bush has proposed only $10 million. Even his proposal to make the R&D tax credit permanent fails to modernize and expand the credit as proposed by the Progressive Policy Institute's New Economy Task Force, chaired by Senate Democratic leader Tom Daschle.

A New Economy investment agenda should:

• **Expand federal support for research:** As a share of GDP, federal support for research and development is 24 percent lower than it was 10 years ago. Last year's Republican-sponsored budget resolution called for federal support for R&D actually to decline by 7.8 percent (inflation adjusted) by 2005, more than five times faster than the decline in total federal spending. The Bush administration should significantly expand funding for federal research (beyond just the National Institutes of Health and Department of Defense weapons systems development).

• **Expand and make permanent the research and development tax credit:** The Bush administration has proposed simply making the credit permanent. That's not enough. It should modernize the credit for the New Economy by adding a more generous credit for collaborative R&D, reforming the alternative minimum credit, and making it easier for small and new businesses to have access to the credit.

• **Increase investments in information technology:** Information technology is central to solving pressing public policy problems. Instead of its minimal $10 million commitment, the administration should create a $500 million annual Digital Government Fund to invest in cross-agency projects. It should double investments in Intelligent Transportation Systems to help solve the nation's transportation problems. It should significantly increase funding for basic and early-stage applied research in information technology as authorized by Congress in 2000.

• **Increase funding and incentives for skills training and education:** As a share of GDP, both federal and private sector investments in training declined in the last decade. It's time to reverse this trend. The Bush administration should support legislation proposed by Sen. Joe Lieberman to create a tax credit for company investments in remedial education, literacy training, and English as a second language. It should provide matching grants to states for incumbent worker training programs, including industry-led regional skills alliances. It should expand loans and fellowships for undergraduate and graduate education in math, science and engineering. ▣

—Robert D. Atkinson

ENGINE OF GROWTH: Virtually all economic research shows that investments in technology and training yield positive, tangible payoffs.

"The New Economy is the kind of transformation that happens perhaps twice in a century. It is equivalent in scope and depth to the ... emergence of the mass-production, corporate economy in the 1940s and '50s."

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— La Plata wool, American cotton, Katanga copper; new trade routes and markets to sell in and so on. This process of industrial change provides the ground swell that gives the general tone to business; while these things are being initiated we have brisk expenditure and predominating prosperity — interrupted, no doubt by the negative phases of the shorter [business] cycles that are superimposed on that ground swell.

Today we are once again undergoing one of those Schumpeterian revolutions — the groundswell — that regularly but infrequently reshape the economy (and society) from top to bottom. Occasional bumps along the way — like the current slump in tech companies — are the negative phases, not the wave itself.

FROM PAPER TO PIXELS: Oracle chairman Larry Ellison says his company cut its costs by $1 billion in 2000 by using the Web to automate internal paper processes.

In addition, if we look at just the tech sector and stock market, it's clear that the media and pundits have painted a misleading picture. Even in mid-March 2001, with the gloomsayers out in full cry, the volatile Nasdaq was still 50 percent higher than when Alan Greenspan warned in December 1996 about "irrational exuberance," while the Dow Jones Industrial Average was 57 percent higher.

Notwithstanding the bankruptcies of Internet high fliers such as eToys.com, venture capitalists continue to have faith in the nation's entrepreneurs. While venture capitalists invested 25 percent less in the fourth quarter of 2000 than they did a year earlier, this was still two-and-one-half times higher than two years before.

Moreover, while the media feverishly report every "pure play" dot-com bankruptcy like a seismic surprise, Internet insiders are unfazed; they knew there had to be a market shakeout sooner or later. Even though the Internet market was steadily growing, it wasn't big enough to support every money-losing dot-com spending millions to gain "eyeballs" and become a household name. This doesn't mean that e-commerce was a high-tech craze like the tulip bulb speculative bubble of the 1630s. The online market continues to grow at a robust pace, with more and more of its work done by traditional "bricks and mortar" companies diversifying into "clicks and mortar" operations. The Census Bureau reports that e-commerce retail sales grew seven times faster than all retail sales in the fourth quarter of 2000 and was 67 percent higher than in the fourth quarter of 1999.

Moreover, between October 2000 and February 2001 Internet growth actually accelerated. Almost five million Internet domain names (e.g., dot-coms) and 17 million Internet hosts (Internet addresses) were added, while the number of users of major Web sites, such as Yahoo, America Online, Microsoft Network, and Geocities, grew by around 5 percent. Internet advertising revenues were up more than 80 percent in 2000 and are expected to

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increase in 2001. Home broadband use increased 150 percent last year and is projected to continue growing rapidly. Worldwide Internet use is expected to more than triple by 2005 to more than 1.5 billion people.

A principal reason for the media's wrong-headed approach to the New Economy shakeout is that the same pundits who erroneously thought that the personal computer was synonymous with the tech revolution of the early 1990s are now the ones who think that e-retailing and advertising-supported Web sites were the be-all and end-all of the tech revolution at the beginning of this decade. Nothing could be further from the truth. No matter how much they grow, Internet retailing and Web sites built on banner ad revenues alone will at best be a modest part of the digital economy. The information technology (IT) revolution is more about how consumers use the Internet to get services (e.g., insurance, banking, airline tickets, government services). For instance, long distance companies like MCI and AT&T reduce customers' long distance bill every month if they agree to do everything by email (no bills by mail). The IT revolution is also transforming how companies are run internally. According to Larry Ellison, chairman of Oracle, the California database company cut its costs by $1 billion in 2000 by using the Web to automate internal paper processes. And IT is about how companies interact with their suppliers. Business-to-business e-commerce is expected to reach $6 trillion by 2005, with annual savings of more than $480 billion by 2003.

ECONOMIC GROUNDSWELL: Economist Joseph Schumpeter, inset, described how new technologies, forms of organization, and sources of supply — such as Katanga copper from Africa — revolutionized the U.S. economy during the mid-20th century. We are again experiencing a Schumpeterian revolution.

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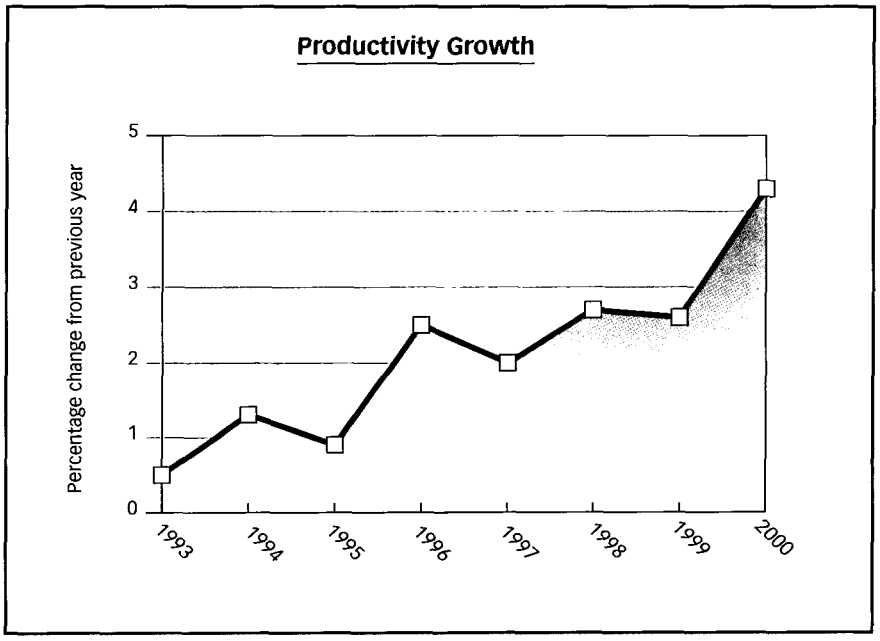
But what about the slowdown in tech investments? Doesn't this mean that the tech revolution has run its course? If the last decade's tech boom occurred just by chance, couldn't it be over? No — it wasn't and it isn't. Technology investments boomed because low interest rates coupled with the emergence of related information technologies gave companies enormously profitable opportunities for investment. And most of these new technologies trace their existence back to federally funded research — an enormous lesson for today's policymakers and doomsayers.



THE CRITICAL NUMBER: The most important measure of economic progress is productivity growth. It increased sharply during the 1990s.

Just as the economic boom that began in the late 1940s was fueled by new electromechanical and chemical technologies that lasted almost 30 years, the current and forthcoming crop of new technologies (especially IT) holds the promise of extending today's investment and productivity boom for at least another 20 years. As a host of new technologies becomes ready for the market, IT investments will remain robust. These include voice recognition, expert systems, smart cards, e-books, cheap storage devices, new display devices and video software, intelligent transportation systems, "third generation" wireless communication devices, and robots.

In the longer term, if business and government continue to support research into technologies such as the super high-speed Internet2, intelligent cars and optical computing and switching, not to mention new technologies based on genomics and nanotechnology, we are on the cusp of a technological transformation.

Another way of understanding why a tech industry shakeout does not signal an end to the New Economy is to look at the most important measure of economic progress: productivity growth. Driven by the tech revolution and other structural changes, productivity growth rebounded vigorously in the past five years from a 20-year trough. In the fourth quarter of 2000, productivity increased 3.2 percent, while for the year it was up a resounding 4.3 percent. This means that American workers produce 4.3 percent more goods and services per hour worked than they did a year earlier. Leaving aside the 1983 post-recession bump in productivity of 4.5 percent after four distinctly sub-par years, that was the highest rate of annual productivity growth since the post-World War II boom. Taken as a whole, economic performance in 2000 was the strongest in a generation. And even in the face of a possible cyclical slowdown in 2001, productivity increases show no signs of abating.

All of these indicators, combined with the Federal Reserve Bank's reversal of an overly tight monetary policy by lowering interest rates to their 1999 levels, suggest that a recession is by no means a sure thing. That's why 95 percent of the forecasters surveyed by the Blue Chip Economic Indicators don't foresee a recession but instead predict 2.1 percent growth in 2001.

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But for the sake of argument, let's say the forecasters get it wrong and the economy goes into a recession. New fundamentals suggest that it is likely to be shorter and less severe than the typical recession in the old economy. Then a leading cause of recessions was the buildup of inventory. As a result, there was economic shrinkage in 21 percent of all calendar quarters between the mid-1940s and mid-1980s. Since the mid-1980s, however, the economy has shrunk in only 7 percent of all quarters. What caused this? Economists point to several factors, including "just in time" production systems and other inventory-reducing practices. Because of these, the inventory-to-sales ratio has been declining since the early 1990s and in 1999 was at its lowest rate since it was first calculated in 1967. These changes have meant that quarter-to-quarter GDP volatility is down significantly since the mid-1980s compared to the 40-year period prior to this.

VEXED FORECASTS: Even Fed chairman Alan Greenspan seemed perplexed by economic gyrations. After holding too tight a rein in 2000, he moved to lower interest rates in 2001. Even with a slowdown, both the Nasdaq and Dow Jones Industrial Average were 50 percent higher in March 2001 than in December 1996 when Greenspan warned of "irrational exuberance."

The real test of the Bush plan

So what does all this mean for the nation's economic policies? It means that tax and budget policies in particular, and economic policy in general, need to reflect the new economic realities. In both areas, the Bush administration has fallen woefully short.

To the extent that there is an economic rationale for the Bush tax cuts, as opposed to simply an ideological commitment to smaller government, it is grounded in supply-side economics. Supply-siders argue that tax cuts always boost economic growth by increasing the supply of labor and capital. Besides the fact that there is little empirical evidence to support this, the goal of economic policy shouldn't be to get people to work more, as supply-side does. It should be to enable people to produce more — that is, to raise productivity, not hours worked. In short, supply-side economics focuses on the old economy factors of capital and labor supply; growth economics focuses on the New Economy factors of capital and labor quality.

Finally, any possible legitimacy supply-side economics once had vanished in the 1990s when, in an effort to balance the budget, President Clinton boosted the top marginal income tax rates, after which, to the surprise of supply-siders, the economy boomed and more people worked.

But if the supply-side argument is now little more than a relic of another economic era, what should the Bush administration be doing to keep the incomes of Americans growing at a robust pace? First, it needs to come to grips with growth economics. The key to growth economics is focusing on productivity as the most important economic statistic. The keys to productivity in an Information Age economy are enforcing fiscal discipline, improving the knowledge and skills of the workforce, promoting public and private investment in research and new technologies, and encouraging competition and innovation, in part through deregulation and expanded global trade.

President Bush should impose fiscal discipline, target investments in knowledge, and support open trade and competition. Whether he does this will be the real test of whether he intends to support continued prosperity or whether his administration is just a throwback to the years of Ronald Reagan and the first George Bush. ▣

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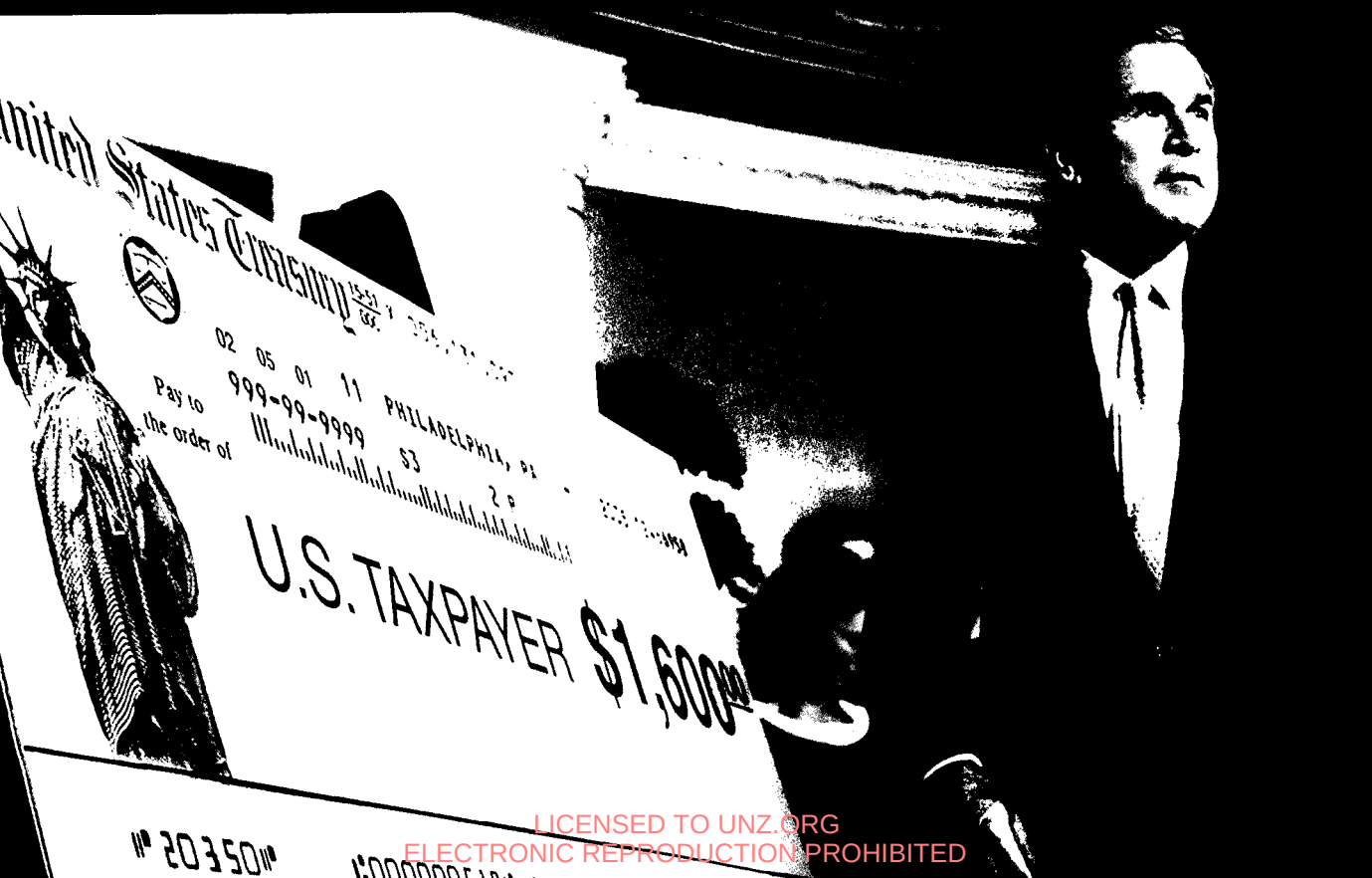
THE LEXUS AND THE MONEY TREE: Democratic congressional leaders Tom Daschle and Richard Gephardt, above, show how Bush's regressive tax cuts would favor people who can afford a $43,000 car. Holding up a goose egg, Daschle says it represents what low earners would get: nothing. Bush, below, uses his own prop to suggest a cash tree showering benefits on everyone.



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Fairness matters

Bush's tax plan fails the progressivity test.

by Robert J. Shapiro

What does a new president do when his predecessor from the other party has left a record of unprecedented prosperity? If you're George W. Bush, you argue that the American economy is in deep trouble and that the only cure is a 10-year, $2 trillion tax cut.

That argument's economic problems are explained elsewhere in this issue. But it's worth recalling that during his presidential campaign, Bush used a different justification for his tax-cut plan: fairness. When government takes in more revenues than it needs, he insisted, it's only fair to return the excess to taxpayers.

In one respect, President Bush is right. The tax system's fairness does matter. Paying taxes is most Americans' chief point of contact with the government. And for many of us, it's the closest approximation we have to a common civic experience. Moreover, since tax collections in the United States depend vitally on voluntary compliance, cynicism may rise and revenues may fall if people feel the tax system is tilted against them.

But the president couldn't be more wrong about his proposal's fairness. By providing far greater tax benefits to the wealthy than to the middle class and the poor, it would make the tax system less progressive across the income scale. What's fair about that?

At bottom, Bush's claim that fairness demands his tax cuts draws on the conservative view (articulated most clearly by Ronald Reagan) that a person's income should generally be beyond the government's reach because it flows from an individual's own efforts. (Of course, this tenet doesn't prevent conservatives from simultaneously arguing that inheritances should also be tax-free.) If individual effort were the only factor that determined income, this argument would be sound. But there's more to income than effort.

To make their case on tax fairness, conservatives misrepresent the character of both markets and democracy. A democratic society probably cannot maintain itself without individual property rights. But individuals make economic choices and produce property within associations and corporations that are the products of law and of communities' political

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decisions. While hardly anyone enjoys paying taxes, most citizens in democracies choose to contribute some of their private resources to provide public goods and services. Moreover, paying taxes in a democracy embodies a civic relationship of mutual responsibility. People's obligation to pay them is as legitimate as any other public duty.

The conservative view on tax fairness also assumes away the countless economic and social differences that arise in a market-based society and that affect individuals' ability to contribute to the common enterprise. Tax fairness for conservatives often comes down to treating everyone as an equal tax unit, which is why many on the right favor a flat tax (in which everyone pays the same percentage), or even a head tax (in which everyone pays the same amount). In a country where government costs are significant and people have a vast range of resources, a flat tax or head tax that leaves some people without the means to support themselves cannot be fair.

President Bush's tax plan, of course, does not go nearly so far, and it would even reduce the tax burden on some moderate-income people. Nonetheless, its essential reliance on flawed conservative tax principles is clear. Ignoring the circumstances of the rich and the poor and the far greater capacity of the wealthy to shoulder current tax burdens, he would provide much greater tax benefits to the wealthy than to the poor or the middle class. And ignoring the heavy burden of payroll taxes on low-income families, he limits his tax cuts to income-tax payers.

"When accidents of birth or luck impair people's ability to succeed, a progressive tax system can provide them with some means and opportunity to participate more fully in the economy."

The Progressive Approach

In contrast, the progressive approach to taxation recognizes the real-world consequences that flow from people's varying circumstances. It holds that people should pay taxes according to their individual ability to do so. The result is a tax system that exempts the poor and applies to everyone else tax rates and relative tax burdens that increase with income and vary with family makeup and age.

The progressive case also appreciates that in a market-based society, people's incomes reflect not only their efforts but also other conditions and circumstances that they do not control. It recognizes that although the market's distribution of incomes may be economically efficient in a narrow sense, it cannot be the final word on economic justice. If differences in people's incomes reflected only how hard they worked, then perhaps it would be unjust to tax wealthy people more heavily than others. But income differences reflect much more than effort, if only because people don't start in the same place. People are born with different talents and come to age in families, neighborhoods, and cultures with different resources. And plain luck often plays a role.

America's wide-open markets intensify these factors' effects, so that those gifted with more talent, education, and self-discipline than others can prosper greatly. This is especially true compared to many other advanced countries whose markets and laws are not as hospitable to the prosperous as ours. The economic benefits of wide-open markets are large, but one of the social costs is often harsh inequalities. The wealthy have a responsibility, then, to bear not merely an equal share of the burden but a *greater* share, because they enjoy a larger share of the benefits provided by our laws and markets. And when accidents of birth or luck impair people's ability to succeed, a progressive tax system can provide them with some means and opportunity to participate more fully in the economy.

Progressive taxation has a strong claim to protecting individuality as well as justice because it also can curb concentrations of economic power and provide poor families with resources they need to live independently. Economic justice is linked to equality of opportunity, a social achievement that progressive taxation advances by *changing* the market's distribution of income. Changing this distribution is a basic measure of progressive tax fairness: After paying taxes, those at the top are left with a smaller share of the nation's total income than they had before, and those at the bottom with a larger share.

A progressive tax system like ours can ameliorate the worst poverty. But it cannot create economic equality. Lifting tens of millions of poor people into the middle class by direct

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income transfers, financed by taxes, would require much higher tax burdens on almost everyone. Meanwhile, at the top of the income distribution, the income tax applies only to people's incomes and not to their accumulated wealth, and so can only modestly affect concentrations of wealth and economic power.

Six Elements That Advance Fairness

Despite its limitations, the current federal tax system contains six progressive elements that advance fairness. For poor Americans, (1) an exemption for initial income protects them from the income tax, and (2) the Earned Income Tax Credit, in effect, refunds part of the payroll tax and other tax payments of working-poor families. For everyone else, (3) the tax rates on personal income rise from 15 percent to nearly 40 percent as a person's income increases. And for the richest Americans, (4) most of the value of their personal deductions is phased out at high-income levels; (5) the federal corporate tax affects mainly owners of capital, who are predominantly affluent; and (6) estate taxes affect only inheritances above $675,000, a threshold that will gradually rise to $1 million after 2005.

The current tax system also has significant regressive elements. For instance, the payroll-tax burden declines as income rises, while the tax benefits from most deductions and exemptions increase with income. In addition, the system provides higher-income people with large tax benefits for saving and investing, which the middle-class and poor often cannot afford.

The result is a tax system that is progressive at the top and bottom but not the middle. After paying all their taxes, poor Americans end up with a larger share of national income than they began with, and wealthy people end up with a smaller share. For most middle-class Americans, however, the tax system is more flat than progressive: They end up with roughly the same share of national income post-tax as they had pre-tax.

What's the bottom line on President Bush's tax plan? Simply put, it is unfair. It would make the system less progressive across the income scale. President Bush would significantly weaken two of the current system's six progressive elements — by cutting the top tax rate more than other rates and by ending the estate tax. The plan also would intensify a regressive feature in the current system, under which Americans' tax rates and tax bills rise more steeply as they progress from poverty to the middle class than they do as they advance from middle class to affluence. President Bush also would provide no tax benefits at all to the poorest working Americans, who pay high payroll taxes but no income tax, and scant benefits to middle-income people who pay more payroll taxes than income taxes. To be sure, these generally regressive effects on moderate and middle-income people are softened for those who also have children, but not for anyone else.

By disproportionately benefiting wealthy people and leaving out the poorest workers, the president's proposal would unavoidably increase economic inequality. And that is contrary to the basic tenets of fairness. ▣

Who Bears the Federal Tax Burden?

- Taken as a whole (i.e., personal and corporate income taxes, payroll taxes, excise taxes, and estate taxes), the federal tax system is most progressive at the top and the bottom of the income scale. The poor end up with a greater share of total national income after paying taxes and receiving tax transfers, and the rich with a smaller share. Taxes barely affect the middle class's share.
- Everyone bears some of the tax burden. Wealthy people pay the bulk of all federal taxes because they earn the bulk of all income. But even families living in poverty, on average, pay more than 6 percent of their income in federal taxes (mainly in the form of payroll taxes).
- A family's tax burden rises most sharply as it moves up from poverty to the middle class. The burden rises at a more modest rate beyond that income stage. For example, a family living on $6,000 a year pays roughly 6.4 percent of its resources in federal taxes. As the family's income rises to $25,000, the share it pays in taxes nearly triples to 16.8 percent. But if the family manages to increase its income twentyfold to $500,000, its tax burden will only double to 32.7 percent.
- The current tax system strongly favors the elderly and families with children. Elderly people pay significantly lower taxes than younger households with the same incomes. Families with children pay less than childless households with the same income, except at high income levels.

—R.J.S.

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AMERICA IS WATCHING: Congress bears a historic responsibility when it comes to cutting up the surplus pie. It should continue the Clinton-era prosperity by paying down the national debt, securing the baby boomers' retirement, and then providing tax relief to those who need it most. The best way is with a 10 percent payroll tax credit or a flat $300 tax credit to every worker.

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Doing it right!

Here's a progressive tax cut and prosperity plan to guarantee the nation's fiscal stability.

by Bruce Reed and Ed Kilgore

In our view, the key questions in this year's tax debate are how to continue the Clinton-era prosperity, pay down the federal debt, secure Social Security and Medicare for the baby boom retirement, and provide tax relief that helps families who work hard and play by the rules — not just how big to make the tax cut. For in the end what matters most is keeping all Americans prosperous, not just giving some (wealthy) Americans a large tax cut.

We agree with President Bush that the surplus is the American people's money. But the national debt — $3.4 trillion — is the people's too. That's all the more reason any tax cut must reflect the American people's values. For most Americans, the Bush tax cut fails on all counts: it doesn't reflect their values, and it gives someone else their money.

President Bush has proposed a tax cut we cannot afford that gives the most to those who need it least. The trouble with the Bush tax cut isn't just the numbers; it's the values. Instead of rewarding work, the Bush tax cut rewards privilege. Instead of expanding opportunity, it threatens our prosperity. Instead of honoring our obligations to our parents and our children, it will leave America completely unprepared when the baby boom generation retires.

New Democrats want a tax cut that is pro-work, pro-family, and pro-growth. It must put prosperity first, but we can't continue prosperity unless we continue to demand fiscal discipline in Washington.

There is a responsible, progressive, and even politically "doable" approach to tax cuts. It draws on the Bush plan's best idea — a doubling of the $500 child tax credit — and also the best idea being proposed by congressional Democrats — a tax credit that helps offset the burden on working Americans who pay high and regressive payroll taxes.

We propose a simple, two-part plan that devotes from $700 billion to $750 billion over 10 years to tax cuts and sets $1 trillion aside to maintain fiscal discipline and prosperity while we wait to see whether future surpluses actually materialize.

Bruce Reed is president of the Democratic Leadership Council. Ed Kilgore is its policy director.

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"For most Americans, the most crushing tax burden isn't the income tax, it's the payroll tax — a regressive tax on work."

1. A Work and Family Tax Cut: American families and American workers built the surplus. Any tax cut should reflect their values and economic interests. Our plan rewards work by providing a new, refundable Work Tax Credit for every working American, and rewards family by doubling the current $500 child tax credit and making it refundable so low-income working families can benefit.

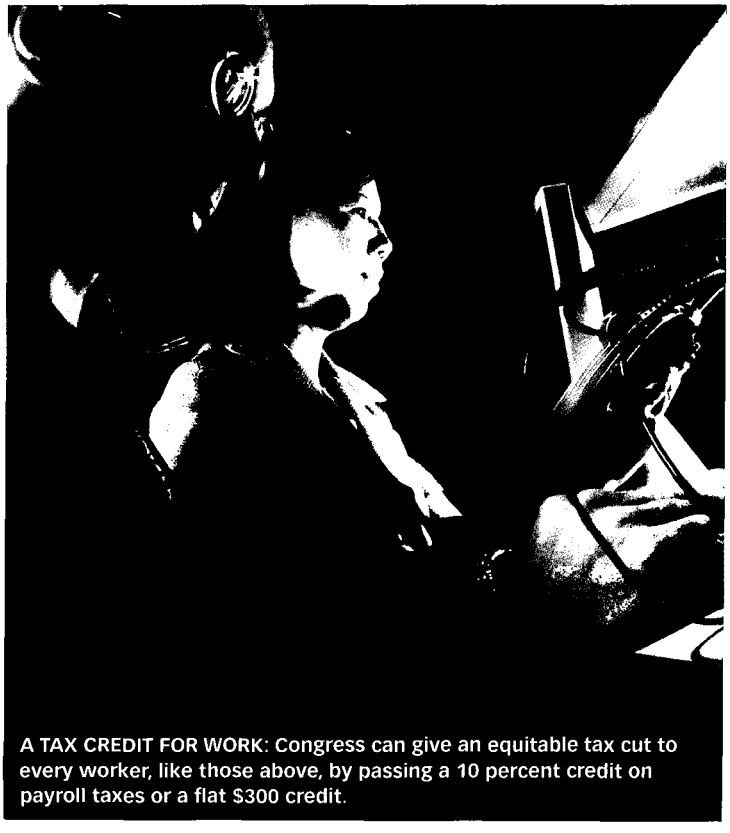
• ***Rewarding work by reducing the work penalty.*** For most Americans, the most crushing tax burden isn't the income tax, it's the payroll tax — a regressive tax on work. This is the dreaded FICA deduction on every pay check. It's time to reduce this penalty on work by giving all working Americans an income tax credit to offset payroll taxes — cutting their income taxes or increasing their refund check. There are two ways to do this in a fiscally responsible manner: a flat $300 credit for every worker, or a credit equal to 10 percent of payroll taxes (see chart on facing page for a comparison of both of these proposals to Bush's plan in terms of who receives the benefits). Either way, unlike the Bush plan, our tax cut provides tax relief to the poorest workers: those who pay payroll taxes but have no income tax liability. It's wrong to give a smaller tax cut to hard-working, middle-class Americans who pay payroll tax on every dollar they earn than to wealthy families who don't. Our plan promotes opportunity, not privilege: People who play by the rules should get the same tax cut.

• ***Rewarding family so no child is left behind.*** Democrats and Republicans agree on the need for tax relief that helps families raise their children. But we want to help every family, not shortchange low-income working families. Like the Bush plan, our plan doubles the existing $500 child tax credit that Congress and President Clinton agreed on in 1997. But unlike the Bush plan, we propose making the new, larger credit refundable, so that low-income working families who don't make enough to pay income tax get the same help with their children that wealthy professionals do. We apply the same principle to tax cuts as the president has embraced on education: no child should be left behind.

Together, this tax cut plan provides roughly the same relief to a two-earner middle-income family of four as the Bush tax plan — $1,600 a year. But our plan makes the relief available to families at the lower end of the income scale as well as at the higher end, and without the monumental downsides of the Bush approach. Low-income families who work hard get rewarded for it, not passed over. Middle-class families with children get the tax relief they deserve, without a massive giveaway to the wealthiest that puts everyone's current prosperity and future retirement at risk.

The $700 billion price tag for our tax cut plan over 10 years — just over a third of the cost of the Bush plan — leaves room beyond these two provisions for targeted tax measures to deal with such problems as the marriage penalty, modest reform of the estate tax, and the need to encourage private retirement savings.

2. A Prosperity Reserve Fund: It won't do any good to cut Americans' taxes if we squander prosperity in the process. Our plan



A TAX CREDIT FOR WORK: Congress can give an equitable tax cut to every worker, like those above, by passing a 10 percent credit on payroll taxes or a flat $300 credit.

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puts prosperity first by setting aside $1 trillion over the next 10 years in a Prosperity Reserve Fund to ensure that we continue to make progress in paying down the national debt and never return to budget deficits. This fund would serve as a hedge against an unexpected economic turndown or revenue shortfall, and would make sure the resources are there to strengthen Social Security and Medicare so that America is ready when the baby boom generation retires, beginning in 2011. In effect, the reserve fund will protect the national interest from special-interest demands for excessive federal spending or tax cuts.

While we think this proposal is the best available, there are obviously other approaches that apply the same basic principles.

Senate Democratic Leader Tom Daschle has proposed dropping the marginal tax rate on the first $12,000 of taxable family income from 15 percent to 10 percent, which essentially would give every family about $600 in quick tax relief. Sen. Joe Lieberman has proposed an immediate $300 rebate to every member of a family who worked last year. Other congressional Democrats have proposed a variety of mechanisms for making tax relief roughly uniform in dollar terms, more targeted to families in need, and less costly to the federal government and to the economy. Any of these approaches would be vastly preferable to the Bush proposal, in terms of the budget, the economy, and the values of the American people.

We believe the essence of fiscal discipline is the steadfast refusal to make promises the country cannot afford to keep. It took 30 years for America to stop running budget deficits. We now have the chance to pay down the national debt and begin paying up the IOUs we already owe for retirement benefits for the baby boomers. The goal of any tax cut and prosperity plan is not short-term politics, but the long-term economic interests and values of the American people over the long term. Since 1993, we've enjoyed eight remarkable years of prosperity that has provided enormous opportunities for Americans. Why let that end? ■

Comparison of Tax Cuts: Bush Plan vs. PPI Proposals, 2006

Proposals Fully Phased In (2006)

	Bush 2006	PPI Options: 2006	
		$300 per worker tax credit	10% payroll tax credit
Single Worker			
Income $10,000	140	300	77
Income $20,000	300	300	153
Income $30,000	300	300	230
Income $40,000	443	300	303
Income $50,000	689	300	375
Income $80,000	1,409	300	581
Income $160,000	4,650	300	656
Income $500,000	10,209	300	835
Income $1,000,000	25,523	300	1,052
Head of Household with 2 children and childcare expenses			
Income $10,000	0	600	377
Income $20,000	0	2,100	1,953
Income $30,000	313	1,300	1,230
Income $40,000	1,500	1,300	1,303
Income $50,000	1,500	1,300	1,357
Income $80,000	2,554	800	1,081
Income $160,000	4,935	300	656
Income $500,000	9,758	300	835
Income $1,000,000	25,072	300	1,052
Married Joint Return with 2 children and childcare expenses			
Income $10,000	0	900	377
Income $20,000	0	2,400	1,953
Income $30,000	0	1,843	1,472
Income $40,000	1,130	1,600	1,303
Income $50,000	1,600	1,600	1,375
Income $80,000	1,772	1,600	1,581
Income $160,000	3,936	600	967
Income $500,000	9,538	600	1,307
Income $1,000,000	24,852	600	1,525

SOURCE: Progressive Policy Institute

NOTES:
- For these calculations, the Bush plan includes income tax changes and expansion of child tax credit.
- Elements of the Bush plan not included in these figures are: R&D tax credit, two-earner deduction, charitable deduction, estate and gift tax repeal, and other items.
- The PPI proposal includes the work tax credit and expansion of child tax credit.
- Elements of the PPI proposal not included in these figures are: R&D tax credit, two-earner credit, slower phaseout of EITC, estate tax reform, IRA/401(k) expansion with matching for low-income savers, Individual Development Accounts, exemption of some interest, dividend, and capital gains distributions from tax, extending and indexing the alternative minimum tax.
- The PPI work and family tax proposals cost between $700 billion and $750 billion over 10 years. (The PPI investment, savings, and tax efficiency proposals cost about $300 billion over 10 years.)
- These calculations are based on the 2000 tax year. Income is adjusted gross income.

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Death and tax cuts

We should help all Americans build estates, not just enrich the few who already have them.

If anyone ought to welcome President Bush's bid to eliminate the estate and gift tax, Warren Buffett should. According to Forbes magazine, Buffett is worth $28 billion. Repealing the estate tax could save his heirs as much as $15 billion — enough money for one family to buy most of the family farms in Buffett's home state of Nebraska.

But like many of his fellow zillionaires — including William Gates Sr., George Soros, and David Rockefeller — Warren Buffett doesn't want any part of the Bush estate tax plan. He told *The New York Times* that repealing the estate tax would be the moral equivalent of "choosing the 2020 Olympic team by picking the eldest sons of the gold-medal winners in the 2000 Olympics." That's not the American way, Buffett said, because it "means you pass down the ability to command the resources of the nation based on heredity rather than merit."

It's hard to tell which is worse for George W. Bush: a coalition of billionaires opposing his tax cut or a rigorous debate about whether success in America is based on inheritance or merit.

In fact, estate tax repeal exposes all the dirty little secrets of Bushonomics. Like the broader Bush tax plan, outright repeal costs too much, helps too few, does nothing for the economy right now, and could do real damage over the long haul. According to the bipartisan Joint Committee on Taxation, estate and gift tax repeal costs a fortune — $662 billion — over the next 10 years. And who gets to be a trillionaire? Ninety percent of the windfall goes to about 2,400 families a year with estates worth more than $5 million. Now we know why Bush campaigned against Al Gore's targeted tax cuts: They would help too many people.

The estate tax proposal is the most damning proof that no matter what he says about it now, Bush's goal when he proposed his tax plan wasn't to get the economy going again. It was to get conservatives voting again. Not even the most ardent opponents of "the death tax," as conservatives like to call the estate tax, are willing to make a supply-side argument that the key to economic growth is freeing octogenarian tycoons to pass on their full fortunes to a new generation of plutocrats. Of course, they could just be saving Anna Nicole Smith for next year's State of the Union address.

Here's another dirty secret: The Bush tax plan includes a welcome provision, similar to one President Clinton proposed, to let the vast majority of Americans who don't itemize their taxes deduct charitable contributions the way affluent itemizers already do. But repeal of the estate tax would have such a devastating impact on charitable giving that Bush's own adviser on faith-based initiatives, John Dilulio, spoke out against it. In other words, Bush's tax plan challenges middle-class Americans to give to charity and tells rich estates they no longer have to.

The shame in this whole tax cut debate is that if Bush weren't so intent on inverse utilitarianism — ensuring the greatest benefit to the smallest number — he could provide broad relief to those who actually need it without squandering the surplus to help those who don't. For example, Democrats have offered a sensible plan that immediately increases the estate tax exclusion to $4 million per married couple ($2 million per individual) and ups that to $5 million per couple over time. The Democratic plan would repeal the estate tax for three-quarters of those currently liable, leaving less than 1 percent of estates affected by the tax.

Because it exempts most farmers and small businesses instead of multimillionaires, the Democratic alternative costs $40 billion over 10 years. That's about $620 billion less than the cost of repeal, a savings of well over $1 trillion dollars over the next two decades.

So all sides could easily find common ground by agreeing to raise the exemption to protect family farms and small businesses and to use the extra money for something else. But if the president insists on repealing the estate tax altogether, he will be saying that the highest national purpose America can find for more than $1 trillion is to let a few thousand families a year give their children bigger trust funds.

The most prudent use for that money is to set it aside to strengthen Social

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PLAYING FOR KEEPS: Some of the richest men in America — like investor Warren Buffett and Microsoft chairman Bill Gates, above — have gotten rich by playing with their own money but oppose gambling with the people's money. Buffett favors retaining the estate tax because it fosters a society based on merit rather than heredity.

Security and Medicare, which will be running short of cash about the same time the true costs of estate tax repeal start exploding. As more than 100 megamillionaires, led by William Gates Sr., pointed out in their ad campaign against repeal, that lost revenue will be made up either by increasing taxes on those less able to pay or by cutting Social Security and Medicare.

In fact, if conservatives really want to eliminate the estate tax, they should take the long view. Today, estate planning is the exclusive province of the very rich. If we helped all Americans save enough to build estates, the estate tax would be repealed in no time.

One way to do that is through retirement savings plans. If Congress wants to put some money into a tax cut that helps families pass more on to their children, it should pass tax credits for retirement savings so more Americans can build estates in the first place. That would do far more for the economy in the long run than the Bush tax cut, which comes at the expense of eliminating the national debt and raising private savings. Tax credits for retirement savings are also a far better way to honor the basic value that estate tax opponents purport to share: rewarding parents who work and sacrifice so their children will be better off.

Congress has plenty of good savings plans to choose from. Both Al Gore and the Clinton-Gore administration proposed refundable tax credits to create Retirement Savings Accounts, which would match taxpayer savings and provide a higher match for lower-income workers. Bush's only hope for bipartisan Social Security reform is to adopt some form of supplemental retirement accounts that are above and beyond Americans' Social Security checks, not simply carved out of them. Ironically, a big tax cut designed to stop Congress from spending is far more likely to stop the president from reforming Social Security and Medicare, because there won't be enough money left to do so in a politically acceptable way.

But the greatest irony of the estate tax debate is that Warren Buffett, George Soros, and William Gates Sr. understand the American dream so much better than the man who thinks they need a big tax cut to achieve it. Even the wealthiest Americans don't want a Gary Sheffield tax plan that says take care of the top first and worry about the rest of the team later. ■

—Bruce Reed

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ALWAYS A BRIDESMAID: Higher taxes for couples discourages marriage, as these would-be wives protested in August 2000.

Stop taxing marriage

A tax credit in the exact amount of the marriage penalty is progressive, affordable — and could be immediate.

by Sen. Evan Bayh

Sen. Evan Bayh (D-Ind.) is chairman of the Democratic Leadership Council.

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There is widespread agreement among lawmakers in Washington that something must be done to repair the anomaly in our tax code known as the marriage penalty — the peculiar and unintended result of regulations that force some married couples to pay higher taxes than they would if each were a single taxpayer. Under our progressive tax code, the combined income of two married workers is often taxed at a higher rate than their incomes would be if taxed separately. Moreover, couples with near equal salaries pay more of a penalty than those with disparate incomes. Couples earning a combined salary of $70,000 and filing jointly could pay up to $1,500 more in taxes than they would as single filers. That's $1,500 a year straight out of a family's savings, college tuition, or health care costs — just because they have chosen to marry.

Fixing the marriage penalty is a matter of basic principle — it is not right that two individuals pay more in taxes simply because they are married. Marriage tax relief is also sound economic policy. During prosperous times when we enjoy a surplus, we should share the benefits with American families who are working hard to make ends meet. And marriage tax relief is appropriate social policy. Marriages and families are the building blocks of our society. Too many marriages today end in dissolution, and too many families are fractured by financial strain. Whenever we can strengthen families, the benefits will extend far beyond those of a fair fiscal policy.

Unfortunately, even with nearly unanimous support in Congress for reforming the marriage penalty, broad consensus among legislators has been difficult to turn into bipartisan action. Marriage penalty relief has repeatedly fallen victim to the larger debate over our tax system, and some proposals have been ill-conceived and weighed down by exploding costs.

We cannot afford just any approach to fixing the marriage penalty. Of the proposals that Congress and the President will be asked to consider, some actually help people who don't pay a marriage penalty, some cost far more than we can afford, and some do not deserve the title of marriage tax penalty relief at all. One bill advanced by the Republican majority in the last Congress directed more than half of its benefits to those who pay no marriage penalty, while also giving more than half of its benefits to those earning more than $100,000 a year.

It is, in fact, possible to strike the right balance between fiscal responsibility and a socially progressive policy that is best for our country. There is a simple, affordable way to fix the marriage penalty for the vast majority of Americans, a plan which also leaves room for additional tax relief and other important national priorities — such as education reform, a prescription drug benefit, and strengthening Social Security and Medicare.

That is why I proposed the Targeted Marriage Penalty Relief Act, an immediate, affordable, and progressive way to fix the marriage penalty. Under the bill, taxpayers could determine their actual marriage penalty on earned and retirement income and receive a tax credit for exactly that amount. The couple in our example above would get a $1,500 tax credit — effectively money in their pockets.

By targeting the relief only to those who actually pay a penalty, the solution becomes affordable — about $90 billion over 10 years — compared with other overloaded and misdirected plans that would cost as much as *$250 billion.*

Our approach is progressive — everyone making less than $120,000 would have the marriage tax penalty eliminated, and more than half of the benefits would go to those making from $50,000 to $100,000 a year. Our bill also encourages marriage and rewards work for those at lower income levels, who are too often discouraged from marrying because of the penalty, by alleviating the penalty for millions of families who are recipients of the Earned Income Tax Credit.

In Washington, it may be difficult to find anyone who will say they're against fixing the marriage penalty, and most lawmakers will denounce its unfairness. But the greater challenge is finding the will to actually fix it and to do so in a fiscally responsible manner. Today, however, there's no reason why Democrats and Republicans can't unite to eliminate this problem in a logical and affordable way. ■

"There is a simple, affordable way to fix the marriage penalty for the vast majority of Americans, a plan which also leaves room for additional tax relief and other important national priorities."

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Reducing the payroll tax burden

How to achieve a more equitable tax cut by lowering the penalty on work.

TAX-TIME DILEMMA: The dreaded FICA takes a bigger bite out of most incomes than the income tax. A payroll tax credit would fix that.

Given broad agreement that a tax cut is now appropriate, what kind should it be? The best answer is to reduce the burden of the payroll tax — the all-too-familiar FICA entry on everyone's paycheck stub that finances Social Security and Medicare. The payroll tax has risen at a greater rate than the income tax over the last two decades. It imposes a greater and more direct penalty on work. And it is the greater tax burden for the vast majority of Americans.

Wealthy people, whose incomes more than doubled in the 1990s, would reap the lion's share of benefits under President Bush's $2 trillion, 10-year plan to cut income and estate taxes. In contrast, payroll tax relief would provide most of its benefits to moderate and middle-income Americans, whose incomes have grown barely one-tenth as fast as those of the very affluent.

Cutting the payroll tax directly would not be the best way to provide relief, because it would cut into the Social Security trust fund. Instead, Congress should provide every working American with a refundable income-tax credit equal to a portion of what they pay each year in Old Age, Survivors, and Disability Insurance taxes — the Social Security part of the payroll tax.

Substantial payroll-tax relief could be provided for about $750 billion over 10 years. That sum would let us reduce the national debt at about the same rate and support domestic commitments at about the same levels proposed by the Gore presidential campaign last year — even if economic growth were to slip below the pace of recent years.

A refundable income-tax credit equal to 25 percent of what a person or family pays in Social Security taxes would cost $715 billion over 10 years, or about one-third the cost of the president's plan. It would reduce the tax burden on people earning $40,000 annually by $620. Similarly, a family earning $50,000 would get a $775 tax cut, and a family earning $60,000 would save $930.

Moreover, because the proposed credit would be refundable, low-income working families who pay payroll taxes but no income taxes would also benefit. For instance, a family earning $15,000 a year would get nothing under Bush's plan but would collect a $233 check from the Treasury in payroll-tax relief.

We could also opt for a more modest plan that would provide a refundable income-tax credit equal to 20 percent of what people pay in Social Security taxes. That would cost $570 billion over 10 years. A person earning $40,000 a year would save about $500, those earning $60,000 would save $745, and a working family earning $15,000 a year would save $186. ▣

—Robert J. Shapiro

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Fixing the alternative minimum tax

If we don't change it, millions will pay higher taxes.

by Sen. Blanche L. Lincoln

Millions of middle-income Americans expecting a big federal income tax cut might be shocked to know that their taxes might actually rise. The culprit is the individual alternative minimum tax (AMT), which Congress created in 1969 to keep the wealthy from overusing tax breaks to reduce or eliminate their income taxes. A quirk in the law is rapidly exposing more middle-class working families to the AMT, forcing them to pay higher taxes. If President Bush's tax plan is enacted, nearly a quarter of all taxpayers will be affected by 2010. Congress needs to fix the AMT as soon as possible.

The AMT essentially is a tax on the use of tax incentives and preferences. Generally speaking, it begins to kick in as income rises into the $60,000 to $70,000 range. When the regular tax code gives taxpayers "too many breaks," they must pay either their regular tax liability or their AMT tax liability, whichever is higher.

The problem with the AMT is that its income exemption thresholds — currently $45,000 for married couples filing jointly and $33,750 for singles — are not indexed for the rising cost of living. Inflation over the past decade and the creation of new income tax credits in 1997 have combined to ensure an explosion in coming years in the number of taxpayers who could be forced to pay the AMT. Despite being eligible for important non-refundable personal tax credits, millions of middle-income families will wind up paying higher taxes. For example, the AMT will prevent many such families from enjoying the $500-per-child tax credit (much less Bush's plan to double that credit to $1,000). The AMT would similarly devalue the Hope college scholarship tax credit, the lifetime learning credit, and the adoption credit.

The Treasury Department and Congress's Joint Tax Committee predict that unless adjustments are made, the number of Americans paying the AMT will balloon from 1.3 million in 2000 to 17 million in 2010. And that's just the tip of the iceberg. The number would skyrocket to 27 million taxpayers under President Bush's $2 trillion, 10-year tax cut plan, which totally ignores AMT reform. That's about one out of every four taxpayers.

ROUGH ROAD AHEAD: Without reform, the AMT will prevent millions of mid-income families from enjoying the child tax credit and other non-refundable tax breaks.

Congress gave families temporary relief from the AMT in 1998 and 1999 by allowing individuals to offset their regular income tax by the full amount of their non-refundable personal tax credits, regardless of the AMT. This provision is set to expire at the end of this year. Legislation that I introduced in 1999 and 2000 to make the provision permanent were wrapped into other tax bills that died for other reasons. I'm determined to make AMT reform a significant part of this year's tax debate.

The AMT can't be fixed cheaply. In fact, reform would consume almost $200 billion of the surplus. But we must fix it because it is so harmful to hard-working, middle-income taxpayers. To them, every penny counts. We must relieve them of the potential burden of the AMT without delay. ▣

Sen. Blanche L. Lincoln (D-Ark.) is a member of the Senate Finance Committee.

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A health care tax credit to cover the uninsured

Conservatives will like the private coverage, while liberals will like the public financing.

by David Kendall, Jeff Lemieux, and S. Robert Levine, MD

During his presidential campaign, George W. Bush pledged to do something about the 43 million Americans who still do not have health insurance. But you would never know that from his actions in his first few months in office. Clearly, President Bush is so focused on ramming his tax cuts for the wealthy through Congress that he has little time to concentrate on the nation's critical social investments.

He should reconsider his priorities. For instance, by marrying today's large surpluses with a progressive approach to cutting taxes, we could significantly reduce the ranks of the uninsured and improve the nation's health overall — at about one-fifth of the cost of the president's $2 trillion, 10-year tax cut plan.

The president should embrace bipartisan legislation introduced in the Senate in mid-March that would create a special income tax credit for the purchase of health insurance. The Relief, Equity, Access, and Coverage for Health (REACH) Act, sponsored by Sens. James Jeffords (R-Vt.), John Breaux (D-La.), Blanche L. Lincoln (D-Ark.), and Tom Carper (D-Del.), would allow moderate- and low-income Americans, individually or through their job, to buy the coverage they and their families so urgently need.

The beauty of a fixed-sum, refundable income tax credit (meaning even those too poor to pay taxes would receive a credit) is that it breaks, in a single stroke, the ideological gridlock that has stymied past efforts to achieve universal coverage. Conservatives can take heart from its emphasis on private coverage, while liberals will like its basis in public financing. Rather than offering Americans a government-run system or a fend-for-yourself marketplace, this plan empowers them to take charge of their own care. Consumers need to become the purchasers of health care so that doctors, hospitals, and insurance companies

COVERAGE NOW: Teachers in Texas demonstrate for state paid health insurance.

"Rather than offering Americans a government-run system or a fend-for-yourself marketplace, our plan empowers them to take charge of their own care."

David Kendall is senior fellow for health policy at the Progressive Policy Institute (PPI). Jeff Lemieux is senior economist at PPI. S. Robert Levine, MD is the chair of PPI's Health Priorities Project.

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are responsive to their needs.

The tax credit would let workers buy insurance through their workplace even if their employers did not offer coverage. Employers would be responsible for making the adjustments in a worker's paycheck. They would also send a check to the insurance company to pay the premiums. To offset these administrative costs, employers would also get a tax break.

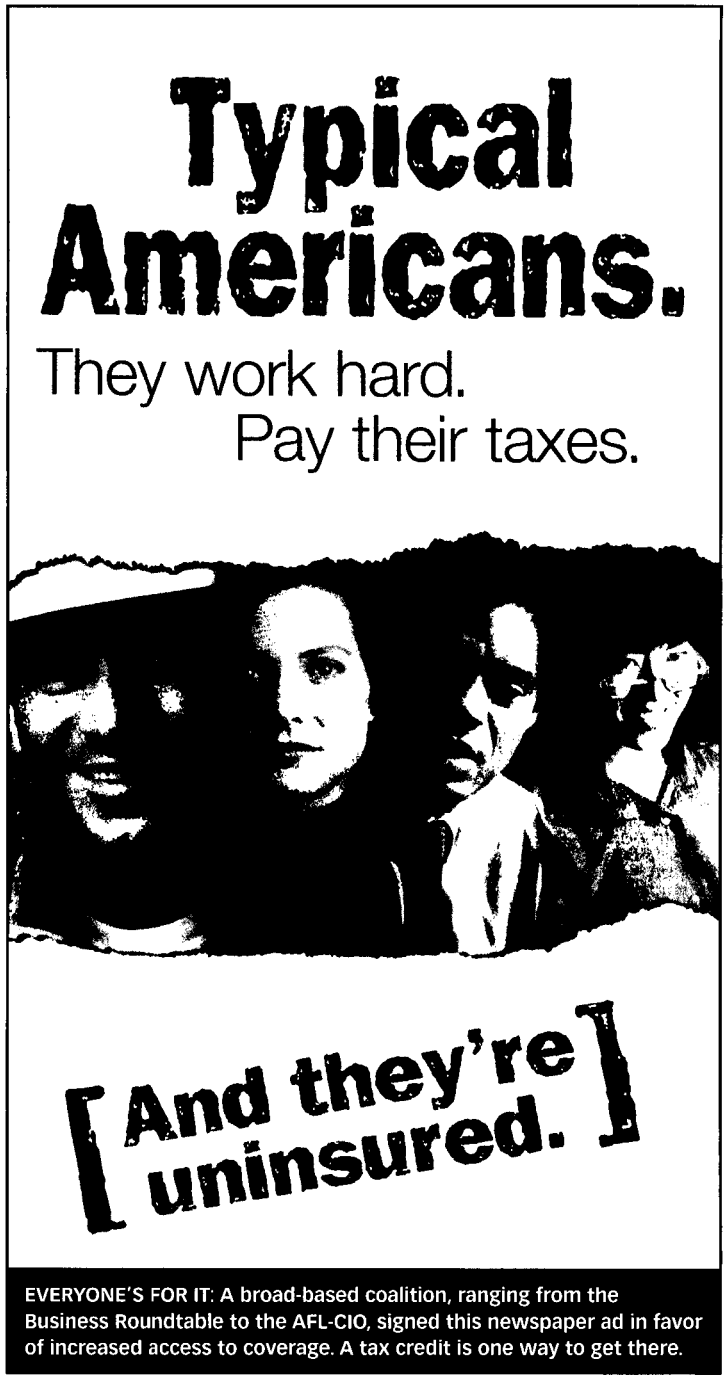
For employees of companies that do not offer insurance, the credit would be worth $2,500 for families and $1,000 for individuals. Workers whose companies do offer coverage would be eligible for a smaller $1,000 family/$400 individual credit. This is designed to both make the workers' share of premiums more affordable and give their companies an incentive to keep their policies. Otherwise, many companies would drop their coverage to let workers take advantage of the bigger tax break.

Low- to middle-income taxpayers would be eligible for the credit. Very-low-income workers would be eligible for the credit even if they did not pay income taxes: They would receive a refundable credit on their payroll taxes, similar to the Earned Income Tax Credit. Higher income taxpayers would remain eligible for the existing tax breaks for health insurance received through a job or as a self-employed worker.

The credit is part of a four-pronged approach for achieving universal coverage. The other components are:

- purchasing groups that let employees choose their own health plan and provide them the information necessary to make the best decision for themselves;
- grants to states so they can help create an equal opportunity for everyone to get health insurance;
- a financial penalty for people who do not acquire coverage once it is affordable and available.

To be sure, this proposal is ambitious and would cost as much as $40 billion annually in lost tax revenues if many of today's uninsured chose to buy coverage. Yet much of that amount would represent a tax cut for low- to middle-income taxpayers who currently have coverage but would gain little from President Bush's tax cut plan. Given the large surplus, this is an ideal time to press for a tax policy that can significantly reduce the ranks of the uninsured. ■



EVERYONE'S FOR IT: A broad-based coalition, ranging from the Business Roundtable to the AFL-CIO, signed this newspaper ad in favor of increased access to coverage. A tax credit is one way to get there.

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What Americans really think about

Bush's Tax Cuts

by Mark J. Penn

The Bush tax plan is out of step with voters' priorities. Education, health care, and a strong economy rank ahead of tax cuts as leading concerns. Most think a $1.6 trillion tax cut favors the wealthy. And alternative approaches enjoy solid support.

Judging by President Bush's unyielding advocacy of tax cuts and media depictions of an "unstoppable" juggernaut, one might assume that the president's tax cut proposal has near-universal public support. This assumption is quite far from reality. Tax cuts, while always popular, are not one of the top items on the national agenda. Not only do American voters have higher priorities than tax cuts for the surplus, they also share different values than President Bush on how taxes should be cut.

Perhaps more importantly, while most voters like the general outlines of the Bush tax cut when it is offered in isolation, support dwindles rapidly when it is put into the context of other budgetary issues, such as paying the national debt. When alternatives to his tax cut are offered, the president loses.

These are some of the conclusions drawn from a DLC-BLUEPRINT poll conducted by Penn, Schoen and Berland Associates Feb. 15-22, 2001, of 500 registered voters. The poll has a margin of error of +/- 4.4 percent, larger for subgroups.

The highlights of the survey include:

- To most voters, the top priorities for the budget surplus are paying down the debt, strengthening Social Security and Medicare, and investing in education, training, and technology. Tax cuts fall behind all of these.
- Most Americans believe we have a budget surplus but think the surplus will not be as large as it is estimated.
- While the Bush tax cut plan draws support, it is vulnerable to the charge that it benefits the haves over the have-nots, especially when it comes to eliminating the estate tax.

Mark J. Penn is the president of Penn, Schoen and Berland Associates Inc., and was the pollster to President Clinton.
Research and polling assistance provided by Jeff Epstein.

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MORE MONEY TO TAKE HOME: A majority of voters, including parents with kids, prefers a reduction of the payroll tax to an income tax cut. Eight in 10 Americans pay more in payroll taxes for Social Security and Medicare than they pay in income taxes.

- A different approach to tax cutting has substantial appeal over the Bush approach.
  - ✓ A majority of Americans would prefer to reduce the estate tax — not eliminate it — so that it applies only to the wealthy.
  - ✓ Voters want to take a more fiscally responsible approach to tax cutting; over two-thirds support a trigger that stops the cut if the projected surpluses don't occur, and three-fourths think we should pass part of the cut now, and part later.
  - ✓ A majority prefers payroll tax cuts to across-the-board tax cuts.

What Democrats should do

It is clear that Americans want a government that is fiscally in order and that promotes economic growth. The Bush tax cut appears to step over the line on these two fundamental elements. It reverses a successful formula that has kept interest rates low, economic growth high, and that has turned dire predictions about the deficit and the collapse of Social Security into myths.

It is most important for Democrats to rise above the specifics of the tax cut and put it in the perspective of the big meta-themes of what they stand for. To the extent that President Bush goes too far and acts unilaterally to pass a tax cut of roughly $2 trillion, he will take on his shoulders full responsibility for the economic performance of the nation. If, instead, the president sees this as too great a risk, then perhaps he will act to fashion a true bi-partisan compromise by reducing the size of the tax cut and incorporating some popular Democratic principles into the bill.

—M.J.P.

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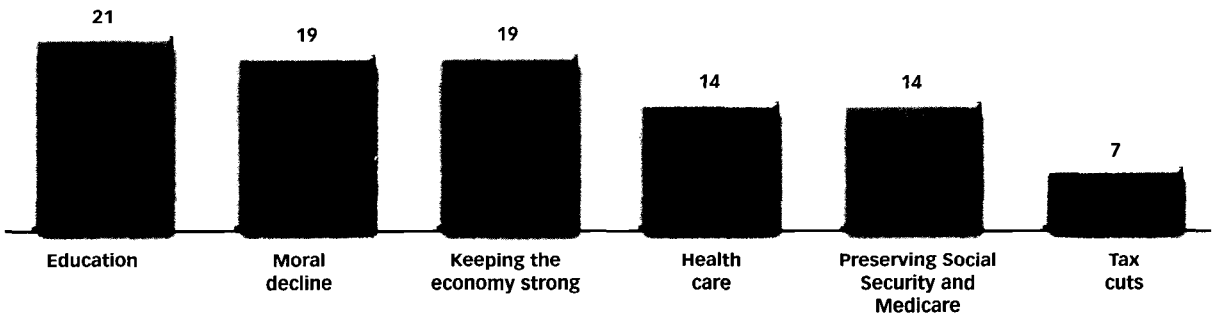
The Poll

Tax Cuts: Important, but not as important as they're made out to be

Despite President Bush's and the GOP's best efforts to make cutting taxes a major issue, it remains low in relative importance to voters. Immediately following his inauguration, President Bush zeroed in on two major issues — education and taxes. While education has consistently been one of the top two or three issues over the past several years, taxes have not. Voters like tax cuts when they are presented in a vacuum. But when compared with several other key issues, tax cuts lose much of their appeal. Education, moral decline, keeping the economy strong, health care, and preserving Social Security and Medicare all rank ahead of tax cuts as the most important issues facing the country. The president says his tax cut is necessary to keep the economy strong. But voters who believe keeping the economy strong is the most important issue say that paying down the debt is the top priority.

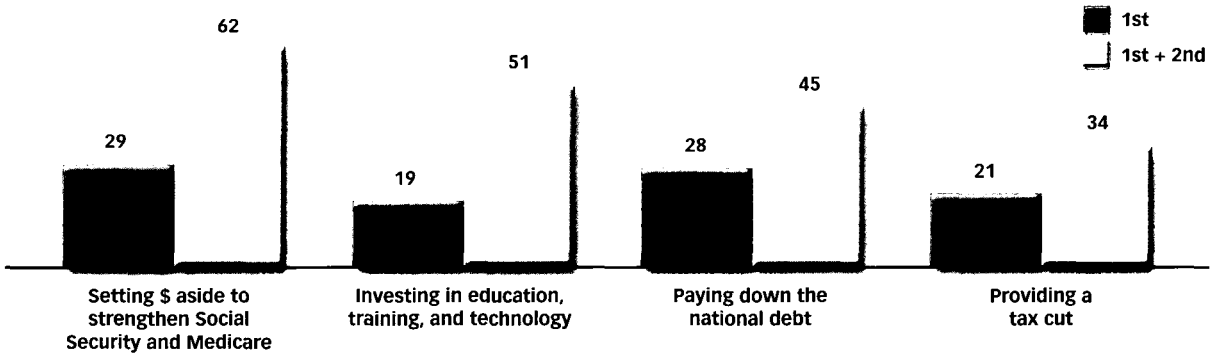
Q. Which of the following issues is the most important issue facing the country?



With 10-year estimates for future budget surpluses now hitting $5.6 trillion, we asked respondents their top two priorities for the surplus. The top priority (29 percent) was "setting aside money to strengthen Social Security and Medicare," followed closely by "paying down the national debt" (28 percent). Tax cuts came in at 21 percent, while investing in education, training, and technology was not far behind at 19 percent.

When the top two choices are combined, tax cuts dropped to the bottom and investing in training, education, and technology rose to the second priority. These are what voters see as the keys to keeping the economy strong, not a huge tax cut.

Q. There is a debate in Washington over what to do with a projected budget surplus that could add up to $5.6 trillion over the next decade. What are your first and second priorities for the budget surplus?



A majority of voters prefers a payroll tax reduction to an income tax cut...

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Examining the data by key voting groups underscores the importance of using the surplus to meet America's key priorities. Those who invest in the stock market and those who are more likely to pay more in taxes support paying down the debt and strengthening Social Security and Medicare more than tax cuts. Among the middle class, the target of Bush's rhetoric, the same dynamic holds true.

Q. What should be the first and second priority for the surplus? (1st + 2nd)

	All	M	F	Investors	Middle class	College education+
Setting money aside to strengthen Social Security and Medicare	62	60	64	58	58	48
Investing in education, training, and technology	51	46	55	51	53	56
Paying down the national debt	45	53	39	50	52	55
Providing a tax cut	34	37	33	37	30	36

As the federal government enters its third year of surpluses, a majority of Americans (53 percent) now believes that there is a surplus. But only 15 percent accept as a given the $5.6 trillion projection on which President Bush has built his tax cut plan. A majority (54 percent) thinks the surplus will be smaller than projected, while 18 percent think it will be larger. Even 52 percent of those who support the Bush tax cut plan have some doubts about how large the surplus will be.

Q. Do you think the actual surplus will be...?

	All	Support Bush tax cut
Larger than projected	18	20
Exactly what is projected	15	17
Smaller than projected	54	52

Despite all the news about tax cuts, the percentage of people who today believe they pay too much in federal income taxes differs little from any time over the last two-and-a-half decades. Just over two-thirds (68 percent) of Americans think they pay too much federal income tax. Close to three in 10 (29 percent) think their tax burden is about right. In the Gallup tracking polls since 1973, the number of people who believe they pay too much in taxes has ranged from a low of 55 percent to a high of 68 percent.

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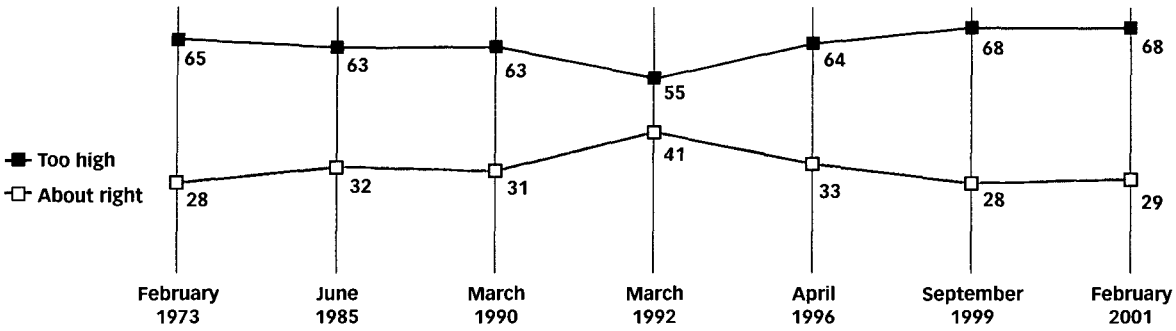
Q. Do you consider the amount of federal income tax you have to pay too high, about right, or too low?



SOURCE: Gallup 1973-1999, PSB 2001

Another of the administration's most common rationales for its tax cut package is that one is needed to stimulate the economy and prevent a recession. While some agree with this argument, it is not one of the top reasons most people favor a tax cut, underscoring the belief that the Bush tax cut is not what the economy needs. On an open-ended basis, the top reason given for a tax cut is that taxes are too high and people feel they pay too much in taxes (22 percent). Twelve percent oppose a tax cut completely, and just 8 percent say we need a tax cut to stimulate the economy.

Q. Why do you think taxes should be cut? [open-ended]

	All
I pay too much in taxes	22
Taxes should not be cut	12
Cost of living / not bringing in enough to pay bills	8
Stimulate the economy	8
Government misspends / wastes money	7
To put more money in my pocket / give me more spending money	6
Surplus means we are paying too much	4
Everyone should pay the same percentage of taxes	4

The results are similar when asking the same question with closed-ended choices. One-third (33 percent) say we need tax cuts because the surplus should be given back, one-third (31 percent) say it is because current rates are too high, and one-quarter (26 percent) say it is to stimulate the economy. Voters with children are slightly more likely to say it is because current rates are too high (39 percent), and GenXers are slightly more likely to say it is because of the surplus (40 percent).

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Q. Which is closer to your view on why we need tax cuts?

	All	Parents	GenX
We have a surplus and part of it should be given back to Americans	33	28	40
Current tax rates are too high	31	39	27
They will stimulate the economy.	26	28	27

President Bush has effectively set up the economic argument for his tax cut by talking down the economy and stating that we are headed for a recession. And even though Federal Reserve Chairman Alan Greenspan has maintained that any tax cut would not be enacted soon enough to prevent a recession, a narrow majority of American voters believes we do need a tax cut to prevent a recession. However, despite the 54-percent to 36-percent margin by which Americans say the economy needs a tax cut to prevent a recession, many key swing groups don't necessarily believe all they hear from the president. Moderates and college graduates hold the view, albeit narrowly, that we don't need a tax cut to prevent a recession. And self-described middle class voters, wired workers, and those who earn over $50,000 annually are deadlocked on the issue.

Convincing voters that a tax cut will save the economy appears to have some impact on support for the Bush tax cut. Out of those who support the Bush tax cut, 61 percent think we need a tax cut to prevent a recession, and out of those who oppose the tax cut, 56 percent think we do not need a tax cut to prevent a recession.

	All	Support Bush tax cut	Oppose Bush tax cut	Moderate	Middle class	Wired worker	$50K+	College degree+
Need tax cut to prevent recession	54	61	35	44	45	48	48	44
Don't need tax cut to prevent recession	36	29	56	47	42	46	45	45

HERE THEY COME: The baby boom retirement is one of the most important fiscal challenges facing the country. Two-thirds of Americans say that paying down the debt and saving Social Security and Medicare is a strong reason to oppose the Bush tax plan.

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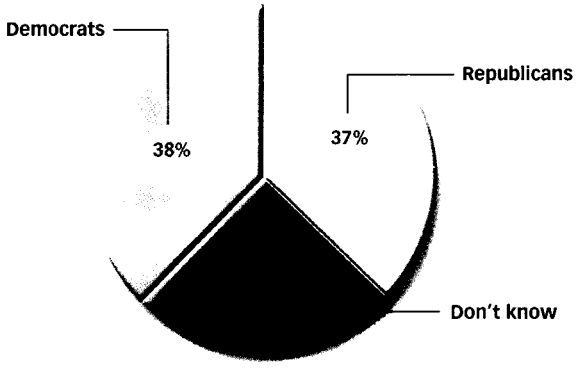
The Politics Behind the Bush Tax Cut

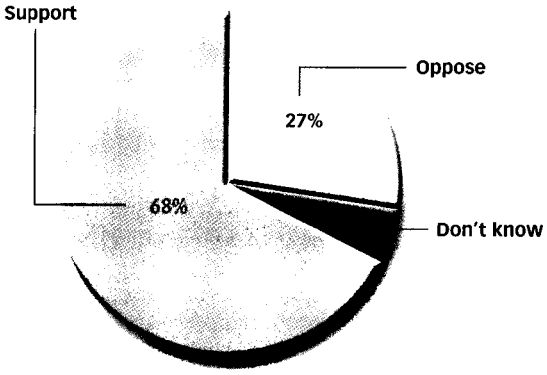
In the wake of an evenly split presidential election that established a 50-50 Senate and a narrow gap between the parties in the House, it is no surprise that the voters are divided on which party they trust to cut taxes responsibly. Thirty-eight percent say Democrats and 37 percent say Republicans. A full quarter (25 percent) say they don't know.

Q. If there is going to be a tax cut, whom do you trust to cut taxes responsibly? Democrats or Republicans?



With the power of the bully pulpit to amplify his message, President Bush's tax plan is supported by two-thirds (68 percent) of the electorate and opposed by a quarter (27 percent). On the surface, the plan enjoys broad support, as narrow majorities say it is fiscally responsible and affordable within the context of our other commitments. However, while support for the Bush plan is high, people are nonetheless divided about whether they would favor a Democratic alternative. A closer analysis of the numbers and some of the subgroups reveals that the Bush plan has weaknesses and does not necessarily represent the values of many Americans.

Q. President Bush's tax cut would repeal the estate tax and gift tax, reduce the marriage penalty, and raise the child tax credit from $500 to $1,000 for many families with kids. It would also lower income tax rates for most tax brackets. The tax reductions would total $1.6 trillion over 10 years. Given this, do you support, somewhat support, somewhat oppose, or strongly oppose President George W. Bush's tax cut plan?



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Q. Do you think we can afford to have this tax cut and still pay down the national debt, preserve Social Security and Medicare, and keep our commitments to education and healthcare, or not?

	All
Can	52
Cannot	40

Q. Do you think this tax cut is a fiscally responsible tax cut, or not?

	All
Yes	50
No	35

Voters have some significant concerns about whether the Bush tax cut plan is fiscally responsible and meets our true national priorities. The biggest concern about the tax cut plan is that it will not leave us enough money for the future. Just over four in 10 (44 percent) are most concerned that the surpluses won't exist and we won't have enough money to pay for the debt or the retirement of the baby boomers. A quarter (24 percent) are most concerned about the fact that the tax cut disproportionately benefits the wealthy, and 13 percent about the fact that the tax cut will not take place soon enough to prevent a recession.

Q. Which of the following is your biggest concern about the Bush tax cut plan?

	All
It disproportionately benefits the very wealthiest	24
It is based on projections of future surpluses that may never exist	22
It doesn't leave enough money to pay off national debt or prepare for retirement of baby boomers	20
It will not take effect soon enough to prevent a recession	13
No concerns	12

Some of these issues were highlighted when respondents were asked whether several common criticisms of the Bush plan were strong or weak reasons to oppose the tax cut plan. The most effective reason was taking care of the most important priorities first, then having a tax cut, rather than vice versa. Two-thirds (67 percent) found that to be a strong reason to oppose Bush's tax cut, including seven in 10 Independents (72 percent) and a majority of those who support the plan (56 percent). Other strong arguments against the Bush plan cited the disproportionate benefits to the wealthiest 1 percent (58 percent strong reason), and the fact that the plan does not promote our values (57 percent strong reason).

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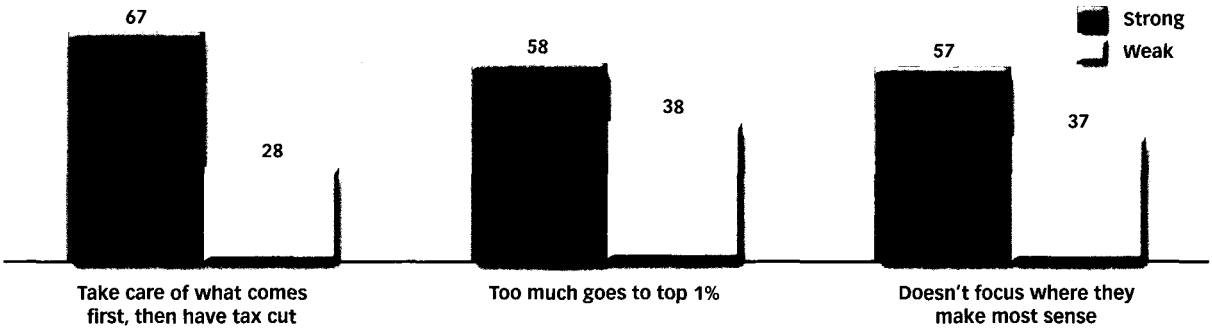
Q. Do you think this is a strong/weak reason to oppose the Bush tax cut plan?



Q. Do you think this is a strong reason or a weak reason to oppose the Bush tax cut plan? (Strong / Weak)

	All	Ind	Support Bush tax cut	Oppose Bush tax cut
Paying down the debt, securing Social Security and Medicare should come first. Bush should take care of these needs and then use what is left for a tax cut, not cut taxes first and then possibly not have enough left over for our obligations.	67/28	72/26	56/39	92/5
Too much of the Bush tax cut goes to the top 1 percent while middle class tax payers receive less than $500 a year.	58/38	60/39	47/51	83/10
Bush's across-the-board tax cut plan does not focus cuts where they make the most sense. What we need is a tax cut that promotes our values, like education, families, health care, and helping people get ahead. That way, we'll give money back to American families, but also have a bigger positive impact on society and the economy.	57/37	57/35	49/45	74/23
This tax cut is too big, spending a surplus that we don't yet have in the bank. Just as the last big tax cut created deficits, so too, could this one unless we trim its size.	54/40	50/42	41/52	86/14
The tax cut won't help the economy, and could even hurt the economy by driving up interest rates. Even Alan Greenspan says this tax cut will not be enacted quickly enough to have any impact on whether or not we have a recession.	48/42	49/37	38/52	75/21

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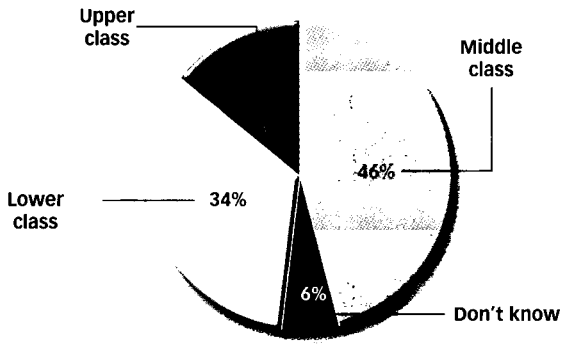
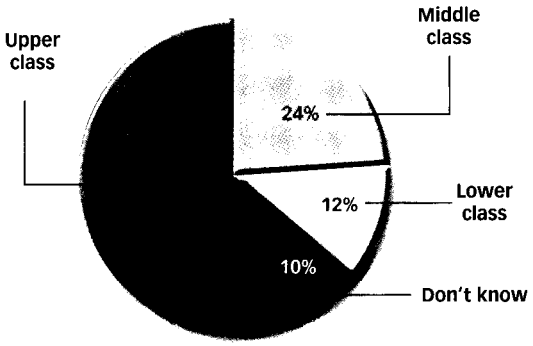
Most Americans are aware of the fundamental unfairness of the Bush plan. A majority (54 percent) thinks the tax cut plan will benefit the upper class the most, while only a quarter think it will benefit the middle class. However, in the poll, only 14 percent describe themselves as upper class, 46 percent as middle class, and 34 percent as lower class. Therefore, most people recognize that the plan will not benefit them and see through the claim that Bush's tax cut is a middle class tax cut. Those who believe the plan will benefit the middle class the most are much more likely to support the plan – they back it 95 percent to 5 percent.

Q. Do you consider yourself...?



Q. Who do you think this plan will benefit the most?



Q. Who do you think this tax cut plan will benefit the most?

	All	Support Bush tax cut	Oppose Bush tax cut	Moderate	Wired worker	College educ+
The upper class	54	40	86	59	62	62
The middle class	24	33	5	22	23	21
The lower / working class	12	15	5	9	4	6

The Estate Tax

Despite all the talk about the importance of eliminating the estate tax, it is the least popular part of the Bush tax cut plan among those who support Bush's proposal as well as among those who oppose it. A third say elimination of the estate tax is the aspect of the tax cut they like the least. Furthermore, when given additional information about the estate tax, including the current and future exemption levels, a majority (56 percent) supports exempting small family farms and small businesses as opposed to eliminating the estate tax (23 percent). Republicans, Independents, and upper income voters earning over $50,000 per year go along with a reduction rather than eliminating the tax as well.

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Q. Which aspect of the tax cut plan do you like the least?

	All	Support Bush tax cut	Oppose Bush tax cut
Elimination of estate and gift tax	32	28	45
Reduction in marginal income tax rates	20	20	23
Reduction of marriage penalty	18	20	15
Increase in child tax credit	12	16	5

Q. A key feature of President Bush's tax cut proposal is the elimination of the estate tax. The estate tax is now levied against estates of more than $600,000. That exemption will soon rise to $1 million. Only the top 2 percent of estates are now subject to the tax. Which is closer to your view?

	All	Rep	Ind	50K+
We should eliminate the estate tax	23	31	26	33
We should leave it as it is	16	14	17	13
We should exempt small family farms and small businesses from the estate tax, but not multimillionaires	56	48	53	48

TOP 2 PERCENT: Estate taxes fall on a tiny number of wealthy people. Most voters favor keeping it if we exempt family farms and small businesses.

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Fiscally Responsible Alternatives

In light of their concerns over the proposed tax cut, Americans show a solid level of support for alternative approaches to tax cuts that are fiscally responsible. Two-thirds (65 percent) support a trigger on the tax cut that would stop the tax cut if the surpluses don't occur or the debt is not paid down. More than 70 percent of moderates and college graduates support the trigger, and 69 percent of wired workers support it.

Another popular alternative is to pass part of the tax cut now, and wait to see if the surplus projections materialize before passing the rest. This proposal is supported by three-quarters of registered voters.

Q. Some people say there ought to be a trigger on the tax cut that stops it if the surpluses don't actually occur. Do you support or oppose this?

	All	Wired worker	Moderate	College educ+
Support	65	69	72	73
Oppose	28	25	24	18

Q. The actual estimated cost to the government of the Bush tax cut, including additional interest payments, is $2 trillion over 10 years. Given this, which is closer to your view?

	All
We should pass the whole tax cut now	19
We should pass part of the tax cut now, and wait to see if the surplus projections come true before passing the rest	74

New Democratic Tax Proposals

The majority of Democrats and Republicans agree there will be a tax cut this year, although there is some disagreement on both the type and the size of the tax cut. The Republican plan is on the table, and Democrats have yet to unify behind one specific plan. We examined some core New Democratic tax cutting principles and proposals that could form the basis for a Democratic tax cut proposal.

One of these central principles is that tax cuts should defend the progressive nature of the tax code. The public broadly supports this idea. When asked whether the rich should get a bigger tax cut because they pay more in taxes or everyone should get the same level of tax cut, seven in 10 think everyone should get the same level.

Q. Which is closer to your view?

	All
The rich should get a bigger tax cut because they pay more in taxes	24
Everyone should get the same level of tax cut	70

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One effective way to cut taxes for middle- and working-class Americans is to give them more money to take home each week by reducing their payroll taxes. Currently, eight in 10 Americans pay more in payroll taxes for Social Security and Medicare than they pay in income taxes. A majority (55 percent) would prefer a payroll tax cut, while one-third (32 percent) would prefer an across-the-board income tax cut. Such a tax cut is also popular with moderates (53 percent prefer it), those who invest in the stock market (54 percent), parents with kids at home (52 percent), and wired workers (55 percent). An across-the-board payroll tax cut is preferred to an across-the-board income tax cut among all economic classes: upper class (55 percent), middle class (53 percent), and lower class (58 percent).

Q. Eight in 10 Americans pay more in payroll taxes for Social Security and Medicare than they pay in income taxes. Given this, which would you prefer?

	All	Moderate	Investor	Have kids	Upper class	Middle class	Lower class	Wired worker
An across-the-board income tax cut	32	36	34	39	36	32	31	34
An across-the-board reduction of payroll taxes paid for out of the surplus, not out of Social Security or Medicare	55	53	54	52	55	53	58	55

ECONOMIC FAIRNESS: Nearly two-thirds of voters support an alternative tax cut that would issue a $300 tax credit to every full-time worker. They also favor the creation of a $1 trillion reserve to pay down the national debt.

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Combining the principles of fiscal responsibility and economic fairness into one tax cut package, we tested an alternative tax cut package to President Bush's. The proposal includes a work tax credit of $300 for every full time worker, doubles the child tax credit to $1000 and makes it refundable so low-income families who pay no income tax would get a refund. It also creates a $1 trillion revenue reserve fund that would guarantee progress toward paying down the national debt and act as a hedge against an unexpected economic downturn or revenue shortfall. This proposal has the support of two-thirds (65 percent) of registered voters and a majority prefers it to the Bush plan. It is effective in persuading people who oppose the Bush tax cut to support an alternative tax cut (67 percent of those who oppose the Bush tax cut support this one) and carries two-thirds of the Bush tax cut supporters (64 percent of Bush tax cut supporters are in favor of this proposal).

Additionally, when asked which plan they would prefer, 51 percent prefer the New Democratic plan to the Bush plan. One-third of the initial supporters of the Bush plan prefer the alternative plan, as well as a majority of Independents, moderates, wired workers, and GenXers.

Q. One tax cut proposal would create a work tax credit of $300 for every full-time worker and double the child tax credit to $1000, making it refundable so low-income families with no federal income tax liability would get a refund. It would also create a $1 trillion revenue reserve fund that would guarantee progress toward paying down the national debt, and act as a hedge against an unexpected economic downturn or revenue shortfall. Do you strongly support, somewhat support, somewhat oppose, or strongly oppose this proposal?

	All	Middle class	Wired worker	Support Bush tax cut	Oppose Bush tax cut	GenX
Support	65	70	72	64	67	72
Oppose	27	21	21	27	29	24

	All	Ind	Support Bush tax cut	Oppose Bush tax cut	Moderate	Wired worker	GenX
President Bush's	34	28	51	6	26	42	20
Tax cut proposal we just discussed	51	54	33	83	64	55	68

Contributing photographers: AP/Wide World - 18, 24-25, 28, 31, 32, 41, 42, 46, 49; Corbis - Cover, inside front cover, 4-5, 9, 13, 21, 29, 32, 45, 53; C-SPAN - 36; FPG - 58, Photo Edit Inc. - 10, 38, 60; The Stock Market - 15, 27, 44.

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Stealing from the young

A twenty-something tells why a whopping tax cut is a mortgage against his generation's future.

by Andrei Cherny

It is a basic rule of horror movies: It's not over till it's over. Just when the hero thinks he has finally killed the attacking monster, the fiend rises up again to shock the audience. So it is with President George W. Bush's tax proposal. Just when we think we've got our killer deficits wrestled to the ground, along comes a president proposing gargantuan tax cuts (made possible only by the fiscal discipline of his predecessor) that will generate gaping deficits again. If the president's plan becomes law, it will not only break the bank, it will break a fundamental generational compact as well. For it will be today's young people who will pay the full price of the selfishness of today's leaders.

Every dollar Bush seeks to spend on his so-called stimulus package is a dollar that cannot be spent paying down the $3.4 trillion national debt or on the reforms that would avert a return to deficit spending. The Bush plan is an instant-gratification scheme that will leave our nation wobbly — and leave young people holding the tab.

From my generation's point of view, what is most appalling about Bush's spending spree is that it squanders a golden moment of opportunity to put America's finances on a secure footing well into the future — *our* future. For the truth is that we haven't entered an era of surpluses so much as a breathing space between two chasms of deficit — the one recently ended and the one waiting for us in 2011 when the baby boomers begin to retire. We overcame the crushing deficit wave created by Ronald Reagan's tax cuts and the Cold War spending spree required to defeat the Soviets. But instead of celebrating, we should be paying attention to the fiscal tsunami that is bearing down on us in the next 10 years.

Ignoring the effects of today's decisions on tomorrow's society is, frankly, an act of bad faith. Thomas Jefferson understood this when he wrote: "A preceding generation cannot bind a succeeding one by its laws or contracts." By wasting money that could be spent preparing for the future, Bush's tax plan violates Jefferson's dictum. The children of the baby boomers will have no freedom to choose their own political destiny.

It requires real political leadership to address this problem before it happens. And both parties have thus far failed us. Nowhere is this more true than when it comes to America's most successful entitlement program — Social Security. What Social Security needs is both more revenue *and* reform. Balancing the books is no longer enough — the status quo is unacceptable. People of my generation are looking for the same choices we have in other aspects of our lives; the same choices the wealthy *already* have when it comes to their retirement planning.

The funds that Bush's plan would spend to placate the Republican right wing's devotion to trickle-down economics could be used not only to pay down the debt, prevent future deficits, and shore up our present programs. They could also be used to fundamentally reform Social Security so that it looks out for the interests of today's young people, *and* reflects their choice-oriented values. By insisting on an artificially bloated tax cut, Bush ties his own hands, leaving no funds to transform Social Security into a system that includes more personally controlled retirement savings accounts but does not harm today's retirees.

The deficit in Washington today is more one of courage than of cash. It takes bravery not to just paper over the pitfalls of our entitlement systems with surplus dollars, but to rejuvenate those programs with new thinking for a new generation. And that's where all too many Democrats fall short. Many want to use our budget surpluses to postpone the day of reckoning for Social Security — keeping the current system alive, if not kicking. Using the surplus to flimsily prop up an antiquated version of Social Security is nearly as bad as squandering the surplus on tax cuts. Both efforts are big-bucks expenditures based on short-term thinking that ignores long-term costs.

For my generation, the true cost of President Bush's tax cut will be measured not in dollars, but in the lost possibility of lasting reform. To us, a tax cut is no benefit if it wrecks our futures and takes away, possibly for our lifetimes, the freedom to choose. ■

Andrei Cherny, 25, is a contributing editor of BLUEPRINT *and the author of* The Next Deal: The Future of Public Life in the Information Age *(Basic Books, 2001).*

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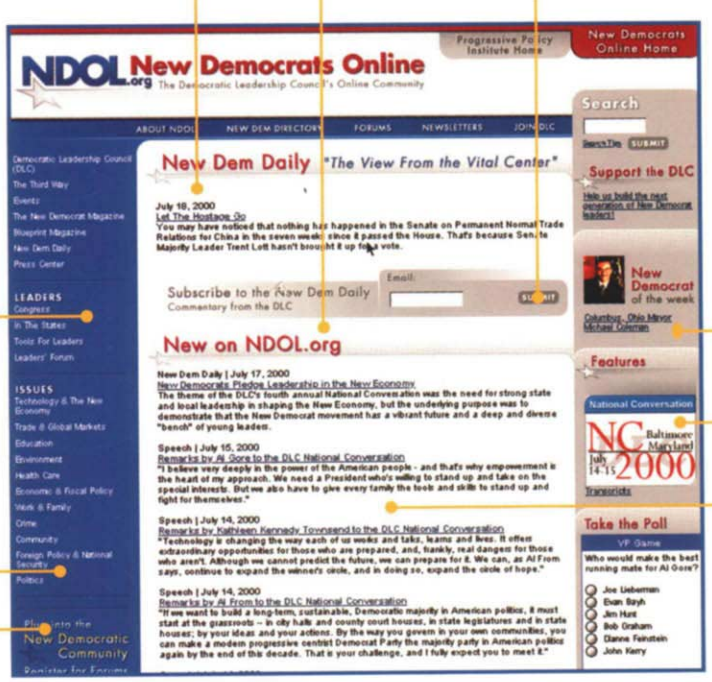

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